

Lloyds TSB Bank plc

Report and Accounts

2004

Member of Lloyds TSB Group

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Directors' report

Results and dividends

The consolidated profit and loss account on page 9 shows a profit attributable to shareholders for the year ended 31 December 2004 of £2,410 million. An interim dividend of £599 million for the year ended 31 December 2004 was paid on 24 September 2004. A second interim dividend of £1,314 million will be paid on 24 March 2005.

Principal activities

The Bank and its subsidiaries provide a wide range of banking and financial services through branches and offices in the UK and overseas.

Business review

Profit before tax for the Lloyds TSB Bank Group was £3,523 million, a decrease of £848 million compared with £4,371 million in 2003. This decrease was attributable to the impact of the profit on the sale and trading results of a number of overseas businesses sold, which contributed £1,183 million in 2003.

To enable meaningful comparisons with 2003, it is appropriate to exclude the impact of these 2003 disposals, together with the investment variance and changes in economic assumptions in the Group's life assurance businesses. On this basis, as a result of earnings growth in each business unit, profit before tax increased by £293 million, or 9 per cent, to £3,378 million.

Strong growth in loans and advances to customers and banks led to an 11 per cent increase in total assets to £281.7 billion. The Group's strategy to increase retail lending, particularly in mortgages, credit cards and personal loans, was reflected in a 14 per cent increase in loans and advances to customers to £156.0 billion. Customer deposits increased by £5.4 billion, or 5 per cent, to £122.4 billion, largely as a result of an 11 per cent growth in current account credit balances.

Group net interest income from continuing operations increased by £180 million, or 4 per cent reflecting strong consumer lending and mortgage growth, and increased lending to corporates.

Cost control continues to have a high priority throughout the Group and during 2004 costs, on a continuing operations basis, increased by only 1 per cent, reflecting good progress in a number of efficiency related initiatives.

Notwithstanding substantial growth in loans and advances to customers, the provisions charge for bad and doubtful debts within the Group's continuing operations was £866 million, 2 per cent lower than in

2003 and, as a result, the Group's provisions charge expressed as a percentage of average lending improved to 0.59 per cent, compared with 0.66 per cent in 2003.

Profit before tax from UK Retail Banking increased by £185 million, or 13 per cent, to £1,655 million, compared with £1,470 million in 2003, supported by continued strong growth in the Group's consumer lending portfolios, partly offset by product margin erosion, higher current account credit balances, improved current account fee income, tight cost control and a lower provision for customer redress. Excluding the impact of provisions for customer redress, profit before tax in UK Retail Banking increased by 5 per cent, with income growth of 4 per cent and cost growth of 1 per cent.

Operating profit from Insurance and Investments, excluding investment variance and changes in economic assumptions, increased by 37 per cent to £774 million, from £566 million in 2003. Excluding the impact of an £88 million reduction in provisions for customer redress, profit before tax from our life, pensions and unit trust businesses increased by £106 million, or 21 per cent, to £617 million. The Group's strategy to improve its profit mix by focusing on more profitable, less capital intensive, business whilst constantly seeking to improve process and distribution efficiency has led to a 21 per cent increase in new business contribution to £188 million. As a result of this focus, strong sales of pensions and single premium investments in the second half of 2004, and a reduced emphasis on certain lower return products, the life and pensions new business margin increased to 28.6 per cent, from 25.8 per cent in 2003. Profit before tax, excluding investment variance, from our general insurance operations increased by £7 million, or 5 per cent, to £160 million.

Wholesale and International Banking pre-tax profit, excluding profit/loss on sale of businesses and trading results of discontinued operations, increased by £219 million, or 21 per cent, to £1,259 million, from £1,040 million in 2003. On the same basis, income growth of 5 per cent exceeded cost growth of 2 per cent. Our focus on cross-selling and capital efficiency has led to an increase in the post-tax return on average risk-weighted assets to 1.42 per cent compared with 1.23 per cent in 2003.

Directors' report

Business review (continued)

In Wholesale, there was strong profit growth in Corporate Markets, Business Banking and Asset Finance, in addition to a reduction in provisions for bad and doubtful debts. In International Banking, profit before tax, excluding the loss on sale of businesses and trading results of discontinued operations, increased by £27 million to £157 million, reflecting a £45 million reduction in provisions.

Shareholders' funds increased by £323 million, or 3 per cent, to £11,056 million. Risk-weighted assets increased by 12 per cent to £132.2 billion, reflecting strong growth in consumer lending and mortgages, higher lending in Corporate Markets and the acquisition of a UK corporate loan portfolio from Danske Bank, and at the end of 2004, the risk asset ratios, the international standard for measuring capital adequacy, were 9.9 per cent for total capital and 9.7 per cent for tier 1 capital. Profit retentions for 2004 totalled £497 million.

FRS 27

In December 2004 the UK Accounting Standards Board ('ASB') issued FRS 27 *Life Assurance* setting out changes to the way in which life assurance business should be accounted for and requiring certain additional disclosures; this standard is effective for accounting years ending on or after 23 December 2005. Although technically not applicable to those reporting under International Financial Reporting Standards in 2005, under the terms of a Memorandum of Understanding entered into between leading members of the life assurance and bancassurance sectors and the Association of British Insurers and the ASB, the Group has committed to implementing the requirements of FRS 27 in 2005 and providing additional disclosures in its 2004 accounts. These disclosures are set out below.

Following the implementation of FRS 27 in 2005 the Group will be required to:

- exclude from the value of in-force business recognised in the balance sheet any amounts that reflect future investment margins; and
- measure the liabilities of the Scottish Widows With-Profits Fund in accordance with the FSA's realistic capital regime, subject to certain specified adjustments. Consequential adjustments are made to the related assets.

The exclusion of future investment margins will result in an adjustment to retained earnings as at

1 January 2004 and will lead to increased volatility in the reported income from long-term assurance business.

The principal subsidiaries involved in the Group's life assurance operations during the year were Scottish Widows plc ('Scottish Widows', the Group's principal provider of life assurance, pensions and investment products, which holds the only large With-Profits Fund managed by the Group), Scottish Widows Annuities Limited (a subsidiary of Scottish Widows that accepts the reinsurance of annuity business from its parent), Abbey Life Assurance Company Limited ('Abbey Life') and Lloyds TSB Life Assurance Company Limited ('Lloyds TSB Life'). Since March 2000 both Abbey Life and Lloyds TSB Life have continued to administer existing policies and have undertaken only limited new business. No change in this activity is anticipated in respect of Abbey Life. On 31 December 2004, Lloyds TSB Life ceased trading and transferred most of its assets and insurance business to Scottish Widows.

Basis of determining regulatory capital of the life assurance business

a) Available capital resources

Available capital resources represent the excess of assets over liabilities calculated in accordance with detailed regulatory rules issued by the Financial Services Authority ('FSA'). Different rules apply depending on the nature of the fund, as detailed below.

Statutory basis. Assets are generally valued on a basis consistent with that used for accounting purposes (with the exception that, in certain cases, the value attributed to assets is limited) and which follows a market value approach where possible. With the express permission of the FSA, an intangible asset can be recognised which represents the present value of future releases of prudent margins on business written. The liabilities are calculated using a projection of future cash flows after making prudent assumptions about matters such as investment return, expenses and mortality. Discount rates used to value the liabilities are set with reference to the risk adjusted yields on the underlying assets in accordance with the FSA rules. Other assumptions are based on recent actual experience, supplemented by industry information where appropriate. The assessment of liabilities does not include future bonuses for with-profits policies that are at the discretion of the company, but does include a value for policyholder options likely to be exercised.

Directors' report

'Realistic' basis. The FSA requires each life assurance company which contains a with-profits fund in excess of £500 million, including Scottish Widows, to carry out a 'realistic' valuation of that fund. The word 'realistic' in this context reflects the terminology used for reporting to the FSA and is an assessment of the financial position of a with-profits fund calculated under a prescribed methodology. The methodology has the effect of limiting the assumed average future investment return to the risk-free rate and represents a best estimate of a theoretical market value of the liabilities.

The valuation of with-profits assets in the With-Profits Fund on a realistic basis differs from the valuation on a statutory basis as, in respect of non-profits business written in the With-Profits Fund, it includes the present value of the anticipated future release of the prudent margins for adverse deviation. The realistic valuation uses the market value of assets without the limit affecting the statutory basis noted above.

The realistic valuation of liabilities is carried out using a stochastic simulation model which values liabilities on a basis consistent with tradable market option contracts (a 'market-consistent' basis). The model takes account of policyholder behaviour on a best-estimate basis and includes an adjustment to reflect future uncertainties where the exercise of options by policyholders might increase liabilities. Further details regarding the stochastic simulation model are given below in the section entitled 'Options and guarantees'.

b) Regulatory capital requirements

Each life assurance company must retain sufficient capital to meet the regulatory capital requirements mandated by the FSA; the basis of calculating the regulatory capital requirement is given below. For the companies described above, with the exception of Scottish Widows, the regulatory capital requirement is a combination of amounts held in respect of actuarial reserves and sums at risk (the Long-Term Insurance Capital Requirement) and amounts required to cover various stress tests. The regulatory capital requirement is deducted from the available capital resources to give 'statutory excess capital'.

For Scottish Widows, a further test is required in respect of the With-Profits Fund which compares the level of 'realistic excess capital' to the 'statutory excess capital' of the With-Profits Fund and, in circumstances where the 'realistic excess capital' position is less, the company is required to hold

additional capital to cover the shortfall. The 'realistic excess capital' is calculated as the difference between realistic assets and realistic liabilities of the With-Profits Fund with a further deduction to cover various stress tests. Any additional capital requirement under this test is referred to as the With-Profits Insurance Capital Component.

The determination of realistic liabilities of the With-Profits Fund in respect of Scottish Widows includes the value of internal transfers expected to be made from the With-Profits Fund to the Non-Participating Fund of Scottish Widows. These internal transfers include charges on policies where the associated costs are borne by the Non-Participating Fund. The value of the transfers exceeds the value of the costs which, in the case of Scottish Widows, results in the somewhat artificial increase in the With-Profits Insurance Capital Component of over £500 million.

c) Constraints over available capital resources

Scottish Widows was created following the demutualisation of Scottish Widows Fund and Life Assurance Society in 2000. The terms of the demutualisation are governed by a Court-approved Scheme of Transfer (the 'Scheme') which, inter alia, created a With-Profits Fund and a Non-Participating Fund and established protected capital support for the with-profits policyholders in existence at the date of demutualisation. Much of that capital support is held in the Non-Participating Fund and, as such, the capital held in that fund is subject to the constraints noted below.

Requirement to maintain a Support Account. The Scheme requires the maintenance of a 'Support Account' within the Non-Participating Fund. The quantum of the Support Account is calculated with reference to the value of assets backing current with-profits policies which also existed at the date of demutualisation and must be maintained until the value of these assets reaches a minimum level. Assets can only be transferred from the Non-Participating Fund if the value of the remaining assets in the fund exceeds the value of the Support Account. Scottish Widows has obtained from the FSA permission to include the value of the Support Account in assessing the realistic value of assets available to the With-Profits Fund. At 31 December 2004, the value of surplus admissible assets in the Non-Participating Fund was £2,222 million and the value of the Support Account was £1,265 million.

Directors' report

Further Support Account. The Further Support Account is an extra tier of capital support for the with-profits policies in existence at the date of demutualisation. The Scheme requires that assets can only be transferred from the Non-Participating Fund if the economic value of the remaining assets in the fund exceeds the aggregate of the Support Account and Further Support Account. Unlike the Support Account test, the economic value used for this test includes both admissible assets and the present value of future profits of business written in the Non-Participating Fund or by any subsidiaries of that fund. The balance of the Further Support Account is expected to reduce to nil by the year 2030. At 31 December 2004, the net economic value of the Non-Participating Fund and its subsidiaries for the purposes of this test was £4,185 million and the combined value of the Support Account and Further Support Account was £2,704 million.

Other restrictions in the Non-Participating Fund. The Scheme states that no amounts can be transferred from the Non-Participating Fund of Scottish Widows unless there are sufficient assets within the Long-Term Fund to meet both policyholders' reasonable expectations in light of liabilities in force at a year end and the new business expected to be written over the following year.

Financial information calculated on a 'realistic' basis

The estimated financial position of the With-Profits Fund of Scottish Widows at 31 December 2004, calculated on a 'realistic' basis, is given in the following table, in the form that the information will be reported to the FSA. As a result of the capital support arrangements, it is considered appropriate to also disclose the 'realistic' financial position of the Long-Term Fund of Scottish Widows as a whole, which consists of both the With-Profits Fund and the Non-Participating Fund.

	With-Profits Fund £m	Long-Term Fund £m
Realistic value of assets of fund	17,814	22,012
Support arrangement assets (value of 'Support Account')	1,265	–
Realistic value of assets available to the fund	19,079	22,012
Realistic value of liabilities of fund	(18,108)	(17,827)
Working capital for fund	971	4,185
Working capital ratio for fund	5.1%	19.0%

Scottish Widows continues to be well capitalised with the working capital ratio for the With-Profits Fund and the Long-Term Fund being an estimated 5.1 per cent and 19.0 per cent respectively.

The realistic liabilities of the With-Profits Fund disclosed above include amounts payable from the With-Profits Fund to the Non-Participating Fund of Scottish Widows in respect of the shareholders' share of future bonuses and other charges due as a result of the Scheme. The value of the liabilities excluding the shareholders' share of future bonuses is £17,988 million. The value of the liabilities excluding the value placed on all interfund transfers is £17,353 million, and the value of excess assets in the With-Profits Fund after eliminating those amounts (excluding the value of the Support Account) is £461 million.

The following table reconciles the value of the Long-Term Fund of Scottish Widows quoted above to the total shareholders' funds attributable to the life assurance business of the Group, calculated on a modified statutory solvency basis:

	Life assurance business £m
Total shareholders' funds on a modified statutory solvency basis* (note 28(h))	4,596
Adjustments to restate amounts onto an FSA statutory basis	(517)
Available capital resources on an FSA statutory basis excluding the With-Profits Fund	4,079
Fund for future appropriations**	1,354
Total available capital resources on an FSA statutory basis	5,433
Capital resources held outside the Long-Term Fund of Scottish Widows	(1,260)
Net effect of adjustments to restate amounts onto a realistic basis	12
Excess assets in the Long-Term Fund of Scottish Widows on a realistic basis	4,185

*A reconciliation of the total shareholders' funds on a modified statutory solvency basis (£4,596 million) to the amount included in the Group's balance sheet on an embedded value basis (£6,796 million) is included in note 28(h) to the financial statements.

**The fund for future appropriations included in the table relates to the With-Profits Fund of Scottish Widows only; the figure disclosed in note 28(h) to the financial statements (£1,379 million) includes £25 million in respect of the other life funds of the Group.

Directors' report

Capital sensitivities

a) Shareholders' funds

Shareholders' funds outside the long-term business fund are mainly invested in assets that are less sensitive to market conditions.

b) With-Profits Fund

The with-profits realistic liabilities and the available capital for the With-Profits Fund are sensitive to both market conditions and changes to a number of non-economic assumptions that affect the valuation of the liabilities of the fund. The available capital resources (and capital requirements) are most sensitive to the level of the stock market, with the position worsening at lower stock market levels as a result of the guarantees to policyholders increasing in value. An increase in the level of equity volatility implied by the market cost of equity put options also increases the market consistent value of the options given to policyholders and worsens the capital position.

The most critical non-economic assumptions are the level of take-up of options inherent in the contracts (higher take up rates are more onerous), mortality rates (lower mortality rates are more onerous) and lapses prior to dates at which a guarantee would apply (lower lapse rates are generally more onerous where guarantees are in the money). The sensitivity of the capital position and capital requirements of the With-Profits Fund is partly mitigated by the actions that can be taken by management.

c) Other long-term funds

Outside the With-Profits Fund, assets backing actuarial reserves in respect of policyholder liabilities are invested so that the values of the assets and liabilities are broadly matched. The most critical non-economic assumptions are mortality rates in respect of annuity business written (lower mortality rates are more onerous). The Group has reduced its exposure to deteriorating mortality rates in respect of life assurance contracts through its reinsurance arrangements. In addition, poor cost control would gradually depreciate the available capital and lead to an increase in the valuation of the liabilities (through an increased allowance for future costs).

Formal intra-group capital arrangements

Scottish Widows has a formal arrangement with one of its subsidiary undertakings, Scottish Widows Unit Funds Limited, whereby the subsidiary company can

draw down capital from Scottish Widows to finance new business which is reinsured from the parent to its subsidiary. Scottish Widows has also provided subordinated loans to its fellow group undertakings, Scottish Widows Annuities Limited and Scottish Widows Bank plc.

Options and guarantees

The Group has sold insurance products that contain options and guarantees, both within the With-Profits Fund and in other funds.

a) Options and guarantees within the With-Profits Fund

The most significant options and guarantees provided from within the With-Profits Fund are in respect of guaranteed minimum cash benefits on death, maturity, retirement or certain policy anniversaries, and guaranteed annuity options on retirement for certain pension policies. As noted above, under the realistic capital regime of the FSA, the liabilities of the With-Profits Fund are valued using a market-consistent stochastic simulation model. This model is used in order to place a value on the options and guarantees which captures both their intrinsic value and their time value.

The most significant economic assumptions included in the model are:

– *Risk-free yield curve*. This is derived from the yield on UK gilts, with an additional 0.1 per cent yield assumed to be risk-free;

– *Investment volatility*. This is derived from derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. As at 31 December 2004, the assumptions were set at 18 per cent for equities, 15 per cent for properties and 13 per cent for interest rates.

The model includes a matrix of the correlations between each of the underlying modelled asset types. The correlations used are consistent with long-term historical returns. The most significant non-economic assumptions included in the model are management actions (in respect of investment policy and bonus rates), guaranteed annuity option take up rates and assumptions regarding persistency (both of which are based on recent actual experience), and assumptions regarding mortality (which are based on recent actual experience and industry tables).

Directors' report

b) Options and guarantees outside the With-Profits Fund of Scottish Widows

Abbey Life currently has a number of policies in-force which have a guaranteed annuity option. In total it holds statutory reserves of £288 million to cover this liability at 31 December 2004. These reserves have been determined using prudent future interest rate, mortality rate and rate of annuity option take-up assumptions and exceed the value that would be placed on them using a market-consistent stochastic model. It is estimated that a 0.5 per cent reduction in future interest rates would increase the liability by some £45 million.

Under some of Abbey Life's older contracts, the maturity value or the surrender value at the end of the selected period is guaranteed to be not less than total premiums paid or sums assured. The total provision for these options was £11 million at 31 December 2004 and was established using stochastic techniques after making prudent assumptions.

In both Abbey Life and Scottish Widows, certain personal pension policyholders, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £89 million in respect of those guarantees. If future salary growth were 0.5 per cent per annum greater than assumed, the liability would increase by some £6 million. If yields were 0.5 per cent lower than assumed, the liability would increase by some £15 million.

Employees

The Bank is committed to employment policies which follow best practice, based on equal opportunities for all employees irrespective of sex, race, national origin, religion, colour, disability, sexual orientation, age or marital status.

In the UK, the Bank supports Opportunity Now and is represented on the board of Race for Opportunity, campaigns to improve opportunities for women and ethnic minorities in the work place. The Bank is a gold card member of the Employers' Forum on Disability, in support of employment of people with disabilities. This recognises the need for ensuring fair employment practices in recruitment and selection,

and the retention, training and career development of disabled staff.

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys. There are well established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions.

Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in the Lloyds TSB Group.

Policy and practice on payment of creditors

The Bank follows 'The Better Payment Practice Code' published by the Department of Trade and Industry regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from The DTI Publications Orderline 0870 1502 500, quoting ref URN 04/606.

The Bank's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated. It is the policy of the Bank to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract.

The number of days required to be shown in this report, to comply with the provisions of the Companies Act 1985, is 28. This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2004 bears to the aggregate of the amounts invoiced by suppliers during the year.

On behalf of the board

A J Michie
Secretary
3 March 2005

Directors

M A van den Bergh

Chairman

D P Pritchard

Deputy Chairman

(leaving on 5 May 2005)

J E Daniels

Chief Executive

M E Fairey

Deputy Chief Executive

H A Weir

Finance Director

W C G Berndt

Ewan Brown CBE

G J N Gemmell CBE

C S Gibson-Smith

(leaving on 5 May 2005)

Sir Julian Horn-Smith

D S Julius CBE

A G Kane

A A Knight

G T Tate

Independent auditors' report

To the members of Lloyds TSB Bank plc

We have audited the financial statements which comprise the consolidated profit and loss account, the balance sheets, the statement of total recognised gains and losses and related notes which have been prepared under the accounting policies set out on pages 13 to 16.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the annual report including, as described below, the financial statements. The United Kingdom Companies Act 1985 requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Bank and the Group as at the end of the year and of the profit or loss for that year. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank and the Group will continue in business.

The directors are responsible for keeping accounting records which disclose with reasonable accuracy at any time the financial position of the Bank and which enable them to ensure that the financial statements comply with the United Kingdom Companies Act 1985. They are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board.

This report, including the opinion, has been prepared for and only for the Bank's members as a body in accordance with Section 235 of the United Kingdom Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Bank has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the directors' report contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Bank and the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Bank and the Group as at 31 December 2004 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the United Kingdom Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton
3 March 2005

Consolidated profit and loss account
for the year ended 31 December 2004

	Note	2004 £ million	Continuing operations 2003 £ million	Discontinued operations 2003* £ million	Total 2003 £ million
Interest receivable:					
Interest receivable and similar income arising from debt securities		423	389	63	452
Other interest receivable and similar income		9,917	8,438	1,213	9,651
Interest payable		5,436	4,103	765	4,868
Net interest income		4,904	4,724	511	5,235
Other finance income	45	39	34	–	34
Other income					
Fees and commissions receivable		3,127	2,990	112	3,102
Fees and commissions payable		(744)	(729)	(34)	(763)
Dealing profits (before expenses)	3	271	525	35	560
Income from long-term assurance business	28	715	436	17	453
General insurance premium income		554	535	–	535
Other operating income		688	687	12	699
		4,611	4,444	142	4,586
Total income		9,554	9,202	653	9,855
Operating expenses					
Administrative expenses	4	4,241	4,155	247	4,402
Depreciation and amortisation	22, 23	633	670	25	695
Total operating expenses		4,874	4,825	272	5,097
Trading surplus		4,680	4,377	381	4,758
General insurance claims		224	236	–	236
Provisions for bad and doubtful debts					
Specific	14	953	883	63	946
General		(87)	4	–	4
		866	887	63	950
Amounts written off fixed asset investments	5	52	44	–	44
Operating profit		3,538	3,210	318	3,528
Share of results of joint ventures	19	–	(22)	–	(22)
(Loss) profit on sale of businesses	6	(15)	–	865	865
Profit on ordinary activities before tax	7	3,523	3,188	1,183	4,371
Tax on profit on ordinary activities	8	1,045	–	–	1,012
Profit on ordinary activities after tax		2,478			3,359
Minority interests: equity		26	–	–	22
: non-equity	38	42	–	–	47
Profit for the year attributable to shareholders	9	2,410			3,290
Dividends	10	1,913	–	–	1,911
Profit for the year	40	497			1,379

*See note 6

Balance sheets
at 31 December 2004

	Note	Group		Bank	
		2004 £ million	2003 £ million	2004 £ million	2003 £ million
Assets					
Cash and balances at central banks		1,078	1,195	998	1,106
Items in course of collection from banks		1,462	1,447	1,416	1,396
Treasury bills and other eligible bills	11	92	539	88	525
Loans and advances to banks	12	23,565	15,547	79,880	62,981
Loans and advances to customers	13	155,981	137,017	77,709	72,428
Debt securities	16	25,194	28,669	16,531	19,558
Equity shares	17	215	458	17	264
Interests in joint ventures:					
– share of gross assets		84	85		
– share of gross liabilities		(31)	(31)		
	19	53	54	35	36
Shares in group undertakings	20	–	–	21,434	19,805
Intangible fixed assets	22	2,425	2,507	107	118
Tangible fixed assets	23	4,181	3,916	1,289	1,297
Other assets	26	3,201	3,925	2,948	3,455
Prepayments and accrued income	27	2,584	1,928	1,871	1,584
Long-term assurance business attributable to the shareholder	28	6,796	6,496	–	–
		226,827	203,698	204,323	184,553
Long-term assurance assets attributable to policyholders	28	54,894	50,200	–	–
Total assets		281,721	253,898	204,323	184,553

The directors approved the accounts on 3 March 2005.

Maarten A van den Bergh
Chairman

J Eric Daniels
Chief Executive

Helen A Weir
Finance Director

Balance sheets

at 31 December 2004

	Note	Group		Bank	
		2004 £ million	2003 £ million	2004 £ million	2003 £ million
Liabilities					
Deposits by banks	30	39,738	23,955	47,568	30,211
Customer accounts	31	122,354	116,944	100,708	100,141
Items in course of transmission to banks		631	626	527	552
Debt securities in issue	32	27,217	25,922	23,407	22,160
Other liabilities	33	6,570	6,789	6,250	6,051
Accruals and deferred income	34	3,912	3,242	2,265	2,135
Post-retirement benefit liability	45	2,231	2,139	–	–
Provisions for liabilities and charges:					
Deferred tax	35	1,476	1,383	(131)	(188)
Other provisions for liabilities and charges	36	417	402	160	142
Subordinated liabilities:					
Undated loan capital	37	5,855	5,962	6,305	6,411
Dated loan capital	37	4,774	4,874	4,174	4,269
		10,629	10,836	10,479	10,680
Minority interests:					
Equity		46	44		
Non-equity	38	550	683		
		596	727		
Called-up share capital	39	1,542	1,542	1,542	1,542
Share premium account	40	2,960	2,960	2,960	2,960
Revaluation reserve	40	–	–	3,827	3,374
Profit and loss account	40	6,554	6,231	4,761	4,793
Shareholders' funds (equity and non-equity)	41	11,056	10,733	13,090	12,669
		226,827	203,698	204,323	184,553
Long-term assurance liabilities to policyholders	28	54,894	50,200	–	–
Total liabilities		281,721	253,898	204,323	184,553
Memorandum items					
46					
Contingent liabilities:					
Acceptances and endorsements		71	299	37	269
Guarantees and assets pledged as collateral security		6,786	6,122	6,899	6,150
Other contingent liabilities		1,669	2,604	1,686	2,648
		8,526	9,025	8,622	9,067
Commitments		85,290	79,335	81,792	76,635

Statement of total recognised gains and losses
for the year ended 31 December 2004

	<i>Note</i>	2004 £ million	2003 £ million
Profit attributable to shareholders		2,410	3,290
Currency translation differences on foreign currency net investments		(11)	118
Actuarial losses recognised in post-retirement benefit schemes		(237)	(6)
Deferred tax thereon		71	2
	45	(166)	(4)
Total recognised gains and losses relating to the year		2,233	3,404
Prior year adjustment in respect of change in accounting policy in 2003		–	(26)
Total gains and losses recognised during the year		2,233	3,378

Historical cost profits and losses

for the year ended 31 December 2004

There was no material difference between the results as reported and the results that would have been reported on an unmodified historical cost basis. Accordingly, no note of historical cost profits and losses has been included.

Reconciliation of movements in consolidated shareholders' funds

for the year ended 31 December 2004

	<i>Note</i>	2004 £ million	2003 £ million
Profit attributable to shareholders		2,410	3,290
Dividends		(1,913)	(1,911)
Profit for the year		497	1,379
Currency translation differences on foreign currency net investments		(11)	118
Actuarial losses recognised in post-retirement benefit schemes	45	(166)	(4)
Goodwill written back on sale of businesses	6	3	181
Net increase in shareholders' funds		323	1,674
Shareholders' funds at beginning of year		10,733	9,059
Shareholders' funds at end of year		11,056	10,733

Notes to the accounts

1 Accounting policies

Accounting policies are unchanged from 2003.

a Accounting convention

The accounts are prepared under the historical cost convention as modified by the revaluation of debt securities and equity shares held for dealing purposes (see g), shares in group undertakings (see h) and assets held in the long-term assurance business (see o); in compliance with Section 255A, Schedule 9 and other requirements of the Companies Act 1985 except as described below (see c); in accordance with applicable accounting standards, pronouncements of the Urgent Issues Task Force and with the Statements of Recommended Practice issued by the British Bankers' Association and the Finance & Leasing Association. The Group's methodology for calculating embedded value follows the guidance published by the Association of British Insurers for the preparation of figures using the achieved profits method of accounting except that tangible assets attributable to the shareholder are valued at market value. The guidance would require those assets backing capital requirements to be discounted to reflect the cost of encumbered capital, but such a treatment would be inconsistent with the treatment of capital supporting the Group's banking operations.

As permitted by Financial Reporting Standard 1 (revised), no cash flow statement is presented in these accounts, as the Bank is a wholly owned subsidiary of Lloyds TSB Group plc which presents such a statement in its own accounts. In addition, advantage has been taken of the exemption available under Financial Reporting Standard 8 not to disclose details of transactions with Lloyds TSB Group plc or other group or associated undertakings, as the consolidated accounts of Lloyds TSB Group plc in which the Bank is included are publicly available.

The Group continues to take advantage of the dispensation in the Urgent Issues Task Force's Abstract 17 'Employee Share Schemes' not to apply that Abstract to the Lloyds TSB Group's Inland Revenue approved SAYE schemes.

b Basis of consolidation

Assets, liabilities and results of group undertakings and joint ventures are included in the consolidated accounts on the basis of accounts made up to 31 December. Entities that do not meet the legal definition of a subsidiary but which give rise to benefits that are in substance no different to those that would arise from subsidiaries are also included in the consolidated accounts. In order to reflect the different nature of the shareholder's and policyholders' interests in the long-term assurance business, the value of long-term assurance business attributable to the shareholder and the assets and liabilities attributable to policyholders are classified under separate headings in the consolidated balance sheet. Details of transactions entered into by the Group which are not eliminated on consolidation are given in note 44.

1 Accounting policies (continued)**c Goodwill**

Goodwill arising on acquisitions of or by group undertakings is capitalised. For acquisitions prior to 1 January 1998, goodwill was taken direct to reserves in the year of acquisition. As permitted by the transitional arrangements of Financial Reporting Standard 10, this goodwill was not reinstated when the Group adopted the standard in 1998.

The useful economic life of the goodwill arising on each acquisition is determined at the time of the acquisition. The directors consider that it is appropriate to assign an indefinite life to the goodwill which arose on the acquisition of Scottish Widows during 2000 in view of the strength of the Scottish Widows brand, developed through over 185 years of trading, and the position of the business as one of the leading providers of life, pensions, unit trust and fund management products. Both of these attributes are deemed to have indefinite durability, which has been determined based on the following factors: the nature of the business; the typical lifespans of the products; the extent to which the acquisition overcomes market entry barriers; and the expected future impact of competition on the business.

As a result the Scottish Widows goodwill is not being amortised through the profit and loss account; however, it is subjected to annual impairment reviews in accordance with Financial Reporting Standard 11. Impairment of the goodwill is evaluated by comparing the present value of the expected future cash flows, excluding financing and tax, (the 'value-in-use') to the carrying value of the underlying net assets and goodwill. If the net assets and goodwill were to exceed the value-in-use, an impairment would be deemed to have occurred and the resulting write-down in the goodwill would be charged to the profit and loss account immediately.

Paragraph 28 of Schedule 9 to the Companies Act 1985 requires that all goodwill carried on the balance sheet should be amortised. In the case of the goodwill arising on the acquisition of Scottish Widows, the directors consider that it is appropriate to depart from this requirement in order to comply with the over-riding requirement for the accounts to show a true and fair view. If this goodwill was amortised over a period of 20 years, profit before tax for the year ended 31 December 2004 would be £92 million lower (2003: £93 million lower), with a corresponding reduction in reserves of £450 million (2003: £358 million); intangible assets on the balance sheet would also be £450 million lower (2003: £358 million lower).

Goodwill arising on all other acquisitions after 1 January 1998 is amortised on a straight line basis over its estimated useful economic life, which does not exceed 20 years.

At the date of the disposal of group or associated undertakings, any unamortised goodwill, or goodwill taken directly to reserves prior to 1 January 1998, is included in the Group's share of the net assets of the undertaking in the calculation of the profit or loss on disposal.

d Income recognition

Interest income is recognised in the profit and loss account as it accrues, with the exception of interest on non-performing lending which is taken to income either when it is received or when there ceases to be any significant doubt about its ultimate receipt (see e).

Fees and commissions receivable from customers to reimburse the Group for costs incurred are taken to income when due. Fees and commissions relating to the ongoing provision of a service or risk borne for a customer are taken to income in proportion to the service provided or risk borne in each accounting period. Fees and commissions charged in lieu of interest are taken to income on a level yield basis over the period of the loan. Other fees and commissions receivable are accounted for as they fall due.

Notes to the accounts

1 Accounting policies (continued)**e Provisions for bad and doubtful debts and non-performing lending****Provisions for bad and doubtful debts**

It is the Group's policy to make provisions for bad and doubtful debts, by way of a charge to the profit and loss account, to reflect the losses inherent in the loan portfolio at the balance sheet date. There are two types of provision, specific and general, and these are discussed further below.

Specific provisions

Specific provisions relate to identified risk advances and are raised when the Group considers that recovery of the whole of the outstanding balance is in serious doubt. The amount of the provision is equivalent to the amount necessary to reduce the carrying value of the advance to its expected ultimate net realisable value.

For the Group's portfolios of smaller balance homogeneous loans, such as the residential mortgage, personal lending and credit card portfolios, specific provisions are calculated using a formulae driven approach. These formulae take into account factors such as the length of time that payments from the customer are overdue, the value of any collateral held and the level of past and expected losses, in order to derive an appropriate provision.

For the Group's other lending portfolios, specific provisions are calculated on a case-by-case basis. In establishing an appropriate provision, factors such as the financial condition of the customer, the nature and value of any collateral held and the costs associated with obtaining repayment and realisation of the collateral are taken into consideration.

General provisions

General provisions are raised to cover latent bad and doubtful debts which are present in any portfolio of advances but have not been specifically identified. The Group has general provisions, held against each of its principal lending portfolios, which are calculated after having regard to a number of factors; in particular, the level of watchlist or potential problem debt, the observed propensity for such debt to deteriorate and become impaired and prior period loss rates. The level of general provision held is reviewed on a regular basis to ensure that it remains appropriate in the context of the perceived risk inherent in the related portfolio and the prevailing economic climate.

Non-performing lending

An advance becomes non-performing when interest ceases to be credited to the profit and loss account. There are two types of non-performing lending which are discussed further below.

Accruing loans on which interest is being placed in suspense

Where the customer continues to operate the account, but there is doubt about the payment of interest, interest continues to be charged to the customer's account, but it is not applied to income. Interest is placed on a suspense account and only taken to income if there ceases to be doubt about its being paid.

Loans accounted for on a non-accrual basis

In those cases where the operation of the customer's account has ceased and it has been transferred to a specialist recovery department, the advance is written down to its expected net realisable value and interest is no longer charged to the customer's account as the likelihood of its recovery is considered remote. Interest is only taken to income if it is received.

f Mortgage incentives

Payments made under cash gift and discount mortgage schemes, which are recoverable from the customer in the event of early redemption, are amortised as an adjustment to net interest income over the early redemption charge period. Payments cease to be deferred and are charged to the profit and loss account in the event that the related loan is redeemed or becomes impaired.

g Debt securities and equity shares

Debt securities, apart from those held for dealing purposes and in the long-term assurance business (see o), are stated at cost as adjusted for the amortisation of any premiums and discounts arising on acquisition, which are amortised from purchase to maturity in equal annual instalments, less amounts written off for any permanent diminution in their value. Equity shares, apart from those held for dealing purposes and in the long-term assurance business (see o), are stated at cost less amounts written off for any permanent diminution in their value.

1 Accounting policies (continued)

Debt securities and equity shares held for dealing purposes are included at market value. In circumstances where securities are transferred between the dealing and investment portfolios, the transfer is effected at an amount based on the market value at the date of transfer. Any resulting profit or loss is reflected in the profit and loss account.

h Shares in group undertakings

Shares in group undertakings are stated in the balance sheet of the Bank at its share of net assets, with the exception of the life assurance group undertakings which are stated on the basis described in o. Attributable goodwill is included, where this has not been written off directly to reserves.

i Tangible fixed assets

Tangible fixed assets are included at cost less depreciation.

Land is not depreciated. Leasehold premises with unexpired lease terms of 50 years or less are depreciated by equal annual instalments over the remaining period of the lease. Freehold and long leasehold buildings are depreciated over 50 years. The costs of adapting premises for the use of the Group are separately identified and depreciated over 10 years, or over the term of the lease if less; such costs are included within premises in the balance sheet total of tangible fixed assets. Equipment is depreciated by equal annual instalments over the estimated useful lives of the assets, which for fixtures and furnishings are 10-20 years and for computer hardware, operating software and application software and the related development costs relating to separable new systems, motor vehicles and other equipment are 3-8 years.

Premises and equipment held for letting to customers under operating leases are depreciated over the life of the lease to give a constant rate of return on the net cash investment, taking into account tax and anticipated residual values. Anticipated residual values are reviewed regularly and any impairments identified are charged to the profit and loss account.

j Vacant leasehold property

When a leasehold property ceases to be used in the business or a commitment is entered into which would cause this to occur, provision is made to the extent that the recoverable amount of the interest in the property is expected to be insufficient to cover future obligations relating to the lease.

k Leasing and instalment credit transactions

Assets leased to customers are classified as finance leases if the lease agreements transfer substantially all of the risks and rewards of ownership to the lessee; all other leases are classified as operating leases.

Income from finance leases is credited to the profit and loss account in proportion to the net cash invested so as to give a constant rate of return over each period after taking account of tax. Income from instalment credit transactions is credited to the profit and loss account using the sum of the digits method. Rental income from operating leases is credited to the profit and loss account on an accruals basis.

In those cases where the Group is the lessee, operating lease costs are charged to the profit and loss account in equal annual instalments over the life of the lease.

l Deferred tax

Full provision is made for deferred tax liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in a tax computation. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted, or where they can be offset against deferred tax liabilities. Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

m Pensions and other post-retirement benefits

The Group operates both defined benefit and defined contribution post-retirement benefit schemes.

Notes to the accounts

1 Accounting policies (continued)

Full actuarial valuations of the Group's principal defined benefit schemes are carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries. For the purposes of these annual updates, scheme assets are included at market value and scheme liabilities are measured on an actuarial basis using the projected unit method; these liabilities are discounted at the current rate of return on a high quality corporate bond of equivalent currency and term. The post-retirement benefit surplus or deficit is included on the Group's balance sheet, net of the related amount of deferred tax. Surpluses are only included to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes. The current service cost and any past service costs are included in the profit and loss account within operating expenses and the expected return on the schemes' assets, after deducting the impact of the unwinding of the discount on scheme liabilities, is included within other finance income. Actuarial gains and losses, including differences between the expected and actual return on scheme assets, are recognised, net of the related deferred tax, in the statement of total recognised gains and losses.

The costs of the Group's defined contribution pension schemes are charged to the profit and loss account in the period in which they fall due.

The majority of the Bank's employees are members of the Group's two main pension schemes, Lloyds TSB Group Pension Schemes No's 1 and 2, along with employees of a number of the Bank's subsidiaries. Because it is not possible to separately identify the amount of any surpluses or deficits in these schemes relating to each employing company, in the accounts of individual companies, including the Bank, these schemes are accounted for as defined contribution schemes in accordance with the requirements of Financial Reporting Standard 17. The Bank charges contributions to these schemes to its profit and loss account as and when they fall due.

n Foreign currency translation

Assets, liabilities and results in foreign currencies are expressed in sterling at the rates of exchange ruling on the dates of the respective balance sheets. Exchange adjustments on the translation of opening net assets held overseas are taken direct to reserves. All foreign exchange gains and losses, which arise from normal trading activities, are included in the profit and loss account.

o Long-term assurance business

The Group accounts for its interest in long-term assurance business using the embedded value basis of accounting. The value of the shareholder's interest in the long-term assurance business ('the embedded value') included in the Group's balance sheet is an actuarially determined estimate of the economic value of the Group's life assurance subsidiaries, excluding any value which may be attributed to future new business. The embedded value is comprised of the net tangible assets of the life assurance subsidiaries, including any surplus retained within the long-term business funds, which could be transferred to the shareholder, and the present value of the in-force business. The present value of the in-force business is calculated by projecting the future surpluses and other net cash flows attributable to the shareholder arising from business written by the balance sheet date, using appropriate economic and actuarial assumptions, and discounting the result at a rate which reflects the shareholder's overall risk premium attributable to this business.

Surpluses arise following annual actuarial valuations of the long-term business funds, which are carried out in accordance with the statutory requirements designed to ensure and demonstrate the solvency of the funds. Future surpluses will depend upon experience in a number of areas such as investment returns, lapse rates, mortality and administrative expenses. Surpluses can be projected by making realistic assumptions about future experience, having regard to both actual experience and forecast long-term economic trends. Other net cash flows principally comprise annual management charges and other fees levied upon the policyholders by the life assurance subsidiaries.

1 Accounting policies (continued)

Changes in the embedded value, which are determined on a post-tax basis, are included in the profit and loss account. For the purpose of presentation, the change in this value is grossed up at the underlying rate of corporation tax.

The assets held within the long-term business funds of the Group's life assurance operations are legally owned by the Group, however the shareholder will only benefit from ownership of these assets to the extent that surpluses are declared or from other cash flows attributable to the shareholder. Reflecting the different nature of these assets, they are classified separately on the Group's balance sheet as 'Long-term assurance assets attributable to policyholders', with a corresponding liability to the policyholders also shown. Investments held within the long-term business funds are included on the following basis: equity shares, debt securities and unit trusts held for unit-linked funds are valued in accordance with policy conditions at market prices; other equity shares and debt securities are valued at middle market price and other unit trusts at bid price; investment properties are included at valuation by independent valuers at existing use value at the balance sheet date, and mortgages and loans are at cost less amounts written off.

p General insurance business

The Group both underwrites and acts as intermediary in the sale of general insurance products. Underwriting premiums are included, net of refunds, in the period in which insurance cover is provided to the customer; premiums received relating to future periods are deferred and only credited to the profit and loss account when earned. Where the Group acts as intermediary, commission income is included in the profit and loss account at the time that the underwriter accepts the risk of providing insurance cover to the customer. Where appropriate, provision is made for the effect of future policy terminations based upon past experience.

The underwriting business makes provision for the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date. Claims equalisation provisions are calculated in accordance with the relevant legislative requirements.

q Sale and repurchase transactions

Securities which have been sold with an agreement to repurchase continue to be shown on the balance sheet and the sale proceeds recorded within deposits by banks or customer accounts as appropriate. Securities acquired in reverse sale and repurchase transactions are not recognised on the balance sheet and the purchase price is recorded within loans and advances. The difference between the sale price and repurchase price is accrued evenly over the life of the transaction and charged or credited to the profit and loss account as interest payable or receivable.

r Derivatives

Derivatives are used in the Group's trading activities to meet the financial needs of customers, for proprietary purposes and to manage risk in the Group's trading portfolios. Such instruments include exchange rate forwards and futures, currency swaps and options together with interest rate swaps, forward rate agreements, interest rate options and futures. These derivatives are carried at fair value and all changes in fair value are reported within dealing profits in the profit and loss account. Fair values are normally determined by reference to quoted market prices; internal models are used to determine fair value in instances where no market price is available. The unrealised gains and losses on trading derivatives are included within other assets and other liabilities respectively. These items are reported gross except in instances where the Group has entered into legally binding netting agreements, where the Group has a right to insist on net settlement that would survive the insolvency of the counterparty; in these cases the positive and negative fair values of trading derivatives with the relevant counterparties are offset within the balance sheet totals.

Notes to the accounts

1 Accounting policies (continued)

Derivatives used in the Group's non-trading activities are taken out to reduce exposures to fluctuations in interest and exchange rates and include exchange rate forwards and futures, currency swaps together with interest rate swaps, forward rate agreements and options. These derivatives are accounted for in the same way as the underlying items which they are hedging. Interest receipts and payments on hedging interest derivatives are included in the profit and loss account so as to match the interest payable or receivable on the hedged item.

A derivative will only be classified as a hedge in circumstances where there was evidence of the intention to hedge at the outset of the transaction and the derivative substantially matches or eliminates the risk associated with the exposure being hedged.

Where a hedge transaction is superseded, ceases to be effective or is terminated early the derivative is measured at fair value. Any profit or loss arising is then amortised to the profit and loss account over the remaining life of the item which it was originally hedging. When the underlying asset, liability or position that was being hedged is terminated, the hedging derivative is measured at fair value and any profit or loss arising is recognised immediately.

2 Segmental analysis

	Profit on ordinary activities before tax	
	2004 £m	2003* £m
Class of business:		
UK Retail Banking	1,655	1,470
Insurance and Investments		
Operating profit	774	566
Changes in economic assumptions	(2)	(22)
Investment variance	147	125
	919	669
Wholesale and International Banking	1,259	1,040
Central group items	(310)	9
	3,523	3,188
Continuing operations	3,523	3,188
Discontinued operations ⁺	-	1,183
	3,523	4,371

Geographical area:**

	Domestic 2004 £m	Inter- national 2004 £m	Total 2004 £m
Interest receivable	9,937	403	10,340
Other finance income	39	-	39
Fees and commissions receivable	2,983	144	3,127
Dealing profits (before expenses)	249	22	271
Income from long-term assurance business	715	-	715
General insurance premium income	554	-	554
Other operating income	682	6	688
Total gross income	15,159	575	15,734
Profit on ordinary activities before tax	3,325	198	3,523

	Domestic 2003 £m	Inter- national 2003 £m	Continuing operations 2003 £m	Discon- tinued operations 2003 ⁺ £m	Total 2003 £m
Interest receivable	8,444	383	8,827	1,276	10,103
Other finance income	34	-	34	-	34
Fees and commissions receivable	2,834	156	2,990	112	3,102
Dealing profits (before expenses)	276	249	525	35	560
Income from long-term assurance business	436	-	436	17	453
General insurance premium income	535	-	535	-	535
Other operating income	682	5	687	12	699
Total gross income	13,241	793	14,034	1,452	15,486
Profit on ordinary activities before tax	2,833	355	3,188	1,183	4,371

Notes to the accounts

2 Segmental analysis (continued)

	Net assets†		Assets‡	
	2004 £m	2003 £m	2004 £m	2003 £m
Class of business:				
UK Retail Banking	2,991	2,554	101,615	90,531
Insurance and Investments	7,350	7,016	10,240	9,859
Wholesale and International Banking	4,469	4,390	112,968	101,286
Central group items	(3,708)	(3,183)	2,004	2,022
	11,102	10,777	226,827	203,698
Geographical area:**				
Domestic	10,448	10,178	213,945	190,926
International	654	599	12,882	12,772
	11,102	10,777	226,827	203,698

*From the beginning of 2004 the Group changed its UK branch and other distribution networks from cost centres to profit centres and, consequently, amended the internal commission arrangements between these networks and the insurance product manufacturing businesses within the Group. The effect of this change has been to redistribute income from the insurance segments to UK Retail Banking and, to a lesser extent, to Wholesale. In addition, certain costs previously included in Central group items were reallocated to the operating segments. The 2003 segmental analysis has been restated to reflect these changes on a consistent basis.

**The geographical distribution of gross income sources, profit on ordinary activities before tax and assets by domestic and international operations is based on the location of the office recording the transaction, except for lending by the international business booked in London.

†See note 6 for details of discontinued operations in 2003, all of which related to the Wholesale and International Banking segment.

‡Net assets represent equity shareholders' funds plus equity minority interests. Disclosure of information on net assets is an accounting standard requirement (SSAP25); it is not appropriate to relate it directly to the segmental profits above because the business is not managed by the allocation of net assets to business units.

‡Assets exclude long-term assurance assets attributable to policyholders.

As the business of the Group is mainly that of banking and insurance, no segmental analysis of turnover is given.

3 Dealing profits (before expenses)

	2004 £m	2003 £m
Foreign exchange trading income	178	228
Securities and other gains	93	332
	271	560

Dealing profits include the profits and losses arising both on the purchase and sale of trading instruments and from the year-end revaluation to market value, together with the interest income earned from these instruments and the related funding cost.

4 Administrative expenses

	2004 £m	2003 £m
Salaries	2,062	2,076
Social security costs	140	142
Other pension costs (note 45)	338	353
Staff costs	2,540	2,571
Other administrative expenses	1,701	1,831
	4,241	4,402

The average number of persons on a headcount basis employed by the Group during the year was as follows:

	2004	2003
UK	74,924	73,814
Overseas	3,372	10,288
	78,296	84,102

The above staff numbers exclude 4,657 (2003: 5,202) staff employed in the long-term assurance business. Costs of £190 million (2003: £194 million) in relation to those staff are reflected in the valuation of the long-term assurance business.

Details of directors' emoluments, pensions and interests are given in note 43.

The auditors' remuneration was £5 million (2003: £5 million), of which £1.6 million (2003: £1.6 million) related to Lloyds TSB Bank plc. Fees paid to the auditors in respect of non-audit services were £9 million (2003: £7 million). Non-audit fees comprise regulatory and other advisory work.

5 Amounts written off fixed asset investments

	2004 £m	2003 £m
Debt securities	43	42
Equity shares	9	2
	52	44

Notes to the accounts

6 (Loss)/profit before tax on sale of businesses	2004	2003	7 Profit on ordinary activities before tax		
	£m	£m	Profit on ordinary activities before tax is stated after taking account of:		
	2004	2003	2004	2003	
	£m	£m	£m	£m	
Profit on sale of businesses in Argentina (tax : £6 million)	6	–			
Loss on sale of businesses in Colombia (after charging £3 million of goodwill previously written off to reserves) (tax: nil)	(20)	–	<i>Income from:</i>		
Loss on sale of businesses in Panama, Guatemala and Honduras (tax : £1 million)	(1)	–	Aggregate amounts receivable, including capital repayments, in respect of assets leased to customers and banks under:		
Loss on sale of French fund management and private banking businesses (tax: nil)	–	(15)	Finance leases and hire purchase contracts	3,742	3,495
Profit on sale of New Zealand operations (after charging £20 million of goodwill previously written off to reserves) (tax: nil)	–	921	Operating leases	422	446
Loss on sale of Brazilian businesses (after charging £161 million of goodwill previously written off to reserves) (tax: nil)	–	(41)	Profits less losses on disposal of investment securities	126	47
	(15)	865	<i>Charges:</i>		
			Rental of premises	212	220
			Hire of equipment	17	18
			Interest on subordinated liabilities (loan capital)	602	599

During 2004 the Group completed the sale, announced on 19 July 2004 and completed on 19 November 2004, of the business of the Bank's branch in Argentina; the sale, announced on 19 July 2004 and completed on 30 November 2004, of the Group's principal businesses in Colombia comprising its interests in Lloyds TSB Bank S.A. and in Lloyds Trust S.A. and certain offshore assets; and the sales, announced on 1 December 2003, of substantially all of the businesses of the Bank's branches in Panama, Guatemala and Honduras which were completed on 30 April 2004, 4 June 2004 and 1 October 2004 respectively.

During 2003 the Group completed the sales of its French fund management and private banking businesses, including its subsidiaries Lloyds Bank SA, Chaillot Assurances SA and Capucines Investissements SA; its Brazilian subsidiaries Banco Lloyds TSB S.A. and Losango Promotora de Vendas Ltda, together with substantially all of the business of the Bank's Brazilian branch and certain offshore Brazilian assets; and its subsidiary, NBNZ Holdings Limited, comprising the Group's New Zealand banking and insurance operations.

The trading results of the businesses sold in 2004 were not material to the Group. Discontinued operations in 2003 comprised the businesses in New Zealand, Brazil and France sold in that year.

Notes to the accounts

8 Tax on profit on ordinary activities**a Analysis of charge for the year**

	2004 £m	2003 £m
UK corporation tax:		
Current tax on profits for the year	868	1,080
Adjustments in respect of prior years	(20)	(88)
	848	992
Double taxation relief	(58)	(223)
	790	769
Foreign tax:		
Current tax on profits for the year	119	144
Adjustments in respect of prior years	(5)	(15)
	114	129
Current tax charge	904	898
Deferred tax	142	121
Associated undertakings and joint ventures	(1)	(7)
	1,045	1,012

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30 per cent (2003: 30 per cent).

In addition to the tax charge in the profit and loss account detailed above, £71 million (2003: £2 million) of deferred tax has been credited to the statement of total recognised gains and losses in respect of actuarial losses recognised in post-retirement benefit schemes (note 45).

b Factors affecting the tax charge for the year

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to profit before tax to the current tax charge and total tax charge for the year is given below:

	2004 £m	2003 £m
Profit on ordinary activities before tax	3,523	4,371
Tax charge thereon at UK corporation tax rate of 30%	1,057	1,311
Factors affecting charge:		
Goodwill amortisation	9	9
Overseas tax rate differences	(14)	(9)
Specifically allowable, unallowable and non-taxable items	(6)	(10)
Net tax effect of disposals	(12)	(276)
Tax deductible coupons on non-equity minority interests	(12)	(12)
Capital allowances in excess of depreciation	(86)	(105)
Other timing differences	(56)	(16)
Life company rate differences	(16)	16
Other items	40	(10)
Current tax charge	904	898
Deferred tax		
– capital allowances in excess of depreciation	86	105
– other timing differences	56	16
Associated undertakings and joint ventures	(1)	(7)
Tax on profit on ordinary activities	1,045	1,012
Effective rate	29.7%	23.2%

8 Tax on profit on ordinary activities (continued)**c Factors that may affect the future tax charge**

The current tax charge includes a charge of £199 million (2003: charge of £157 million) in respect of notional tax on the shareholder's interest in the movement in value of the long-term assurance business (note 28b). Since this derives from the use of a combination of tax rates it can give rise to a higher or lower charge compared to an expected 30 per cent rate.

Future transfers from Scottish Widows plc's long-term business fund to its shareholder's fund will be subject to a shareholder tax charge. Under FRS 19, no provision is required to be made since the timing of such transfers is under Scottish Widows plc's control. The potential deferred tax liability (undiscounted) not recognised on the balance sheet is approximately £230 million (2003: £110 million).

9 Profit for the financial year attributable to shareholders

The profit attributable to shareholders includes a profit of £1,871 million (2003: £2,177 million) dealt with in the accounts of the parent company, for which no profit and loss account is shown as permitted by Section 230 of the Companies Act 1985.

10 Dividends

	2004 £m	2003 £m
First interim	599	597
Second interim	1,314	1,314
	1,913	1,911

No dividends have been paid on the £100 of 6% non-cumulative redeemable preference shares issued in the year (see note 39). Dividends are being accrued at the rate of 6 per cent per annum and the first payment is due in March 2005.

11 Treasury bills and other eligible bills

	2004 Balance sheet £m	2004 Valuation £m	2003 Balance sheet £m	2003 Valuation £m
Group				
Investment securities:				
Treasury bills and similar securities	75	77	308	305
Other eligible bills	13	13	222	218
	88	90	530	523
Other securities:				
Treasury bills and similar securities	4	4	9	9
	92	94	539	532
Geographical analysis by issuer:				
United Kingdom	–		336	
Latin America	18		70	
Other	74		133	
	92		539	
Included above:				
Unamortised discounts net of premiums on investment securities	–		2	

Notes to the accounts

11 Treasury bills and other eligible bills (continued)

Movements in investment securities comprise:	Premiums and discounts		Total £m
	Cost £m	£m	
At 1 January 2004	528	2	530
Exchange and other adjustments	(3)	–	(3)
Additions	430	–	430
Bills sold or matured	(830)	(5)	(835)
Adjustments on disposal of businesses	(37)	–	(37)
Amortisation of premiums and discounts	–	3	3
At 31 December 2004	88	–	88

	2004 Balance sheet £m	2004 Valuation £m	2003 Balance sheet £m	2003 Valuation £m
Bank				
Investment securities:				
Treasury bills and similar securities	75	77	307	305
Other eligible bills	13	13	213	213
	88	90	520	518
Other securities:				
Treasury bills and similar securities	–	–	5	5
	88	90	525	523
Geographical analysis by issuer:				
United Kingdom	–	–	336	–
Latin America	18	–	59	–
Other	70	–	130	–
	88	–	525	–
Included above:				
Unamortised discounts net of premiums on investment securities	–	–	2	–

Movements in investment securities comprise:	Premiums and discounts		Total £m
	Cost £m	£m	
At 1 January 2004	518	2	520
Exchange and other adjustments	(4)	–	(4)
Additions	421	–	421
Bills sold or matured	(820)	(5)	(825)
Adjustments on disposal of businesses	(27)	–	(27)
Amortisation of premiums and discounts	–	3	3
At 31 December 2004	88	–	88

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes.

The difference between the cost of other securities and market value, where the market value is higher than the cost, is not disclosed as its determination is not practicable.

It is expected that tax of £1 million would be payable (2003: £2 million recoverable) if the Group's investment securities were sold at their year end valuation.

12 Loans and advances to banks

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Lending to banks	2,483	2,292	59,361	50,520
Deposits placed with banks	21,083	13,273	20,520	12,479
Total loans and advances to banks	23,566	15,565	79,881	62,999
Provisions for bad and doubtful debts	(1)	(18)	(1)	(18)
	23,565	15,547	79,880	62,981
Repayable on demand	2,477	3,768	25,705	24,574
Other loans and advances by residual maturity repayable:				
3 months or less	16,763	7,637	18,322	9,456
1 year or less but over 3 months	2,243	2,329	9,994	6,804
5 years or less but over 1 year	1,422	1,496	23,497	19,412
Over 5 years	661	335	2,363	2,753
Provisions for bad and doubtful debts	(1)	(18)	(1)	(18)
	23,565	15,547	79,880	62,981
Included above:				
Due from group undertakings				
– unsubordinated			56,706	48,033
– subordinated			525	225

13 Loans and advances to customers

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Lending to customers	146,449	127,551	78,949	73,804
Hire purchase debtors	4,828	4,701	177	58
Equipment leased to customers	6,387	6,470	–	–
Total loans and advances to customers	157,664	138,722	79,126	73,862
Provisions for bad and doubtful debts	(1,662)	(1,677)	(1,408)	(1,419)
Interest held in suspense	(21)	(28)	(9)	(15)
	155,981	137,017	77,709	72,428
Loans and advances by residual maturity repayable:				
3 months or less	30,444	25,005	46,944	42,015
1 year or less but over 3 months	9,878	9,458	8,003	6,752
5 years or less but over 1 year	35,301	31,384	15,259	15,075
Over 5 years	82,041	72,875	8,920	10,020
Provisions for bad and doubtful debts	(1,662)	(1,677)	(1,408)	(1,419)
Interest held in suspense	(21)	(28)	(9)	(15)
	155,981	137,017	77,709	72,428
Of which repayable on demand or at short notice	17,360	14,917	33,783	28,624
Included above:				
Due from group undertakings				
– all unsubordinated			25,184	27,399
Due from fellow group undertakings				
– all unsubordinated	1,741	1,766	649	684

The cost of assets acquired during the year for letting to customers under finance leases and hire purchase contracts amounted to £5,472 million (2003: £4,478 million).

Notes to the accounts

14 Provisions for bad and doubtful debts and non-performing lending

Group	2004	2004	2003	2003
	Specific £m	General £m	Specific £m	General £m
At 1 January	1,313	382	1,334	433
Exchange and other adjustments	(11)	–	(1)	–
Adjustments on acquisitions and disposals	(21)	(12)	(49)	(5)
Transfers from general to specific	3	(3)	50	(50)
Advances written off	(1,028)	–	(1,145)	–
Recoveries of advances written off in previous years	174	–	178	–
Charge to profit and loss account:				
New and additional provisions	1,571	12	1,552	9
Releases and recoveries	(618)	(99)	(606)	(5)
	<u>953</u>	<u>(87)</u>	<u>946</u>	<u>4</u>
At 31 December	<u>1,383</u>	<u>280</u>	<u>1,313</u>	<u>382</u>
	<u>1,663</u>		<u>1,695</u>	
In respect of:				
Loans and advances to banks		1		18
Loans and advances to customers		1,662		1,677
	<u>1,663</u>		<u>1,695</u>	
Bank				
At 1 January	1,119	318	1,056	370
Exchange and other adjustments	(12)	–	(9)	–
Adjustments on acquisitions and disposals	(13)	(12)	33	(5)
Transfers from general to specific	3	(3)	50	(50)
Advances written off	(887)	–	(918)	–
Recoveries of advances written off in previous years	154	–	127	–
Charge to profit and loss account:				
New and additional provisions	1,375	12	1,300	8
Releases and recoveries	(587)	(58)	(520)	(5)
	<u>788</u>	<u>(46)</u>	<u>780</u>	<u>3</u>
At 31 December	<u>1,152</u>	<u>257</u>	<u>1,119</u>	<u>318</u>
	<u>1,409</u>		<u>1,437</u>	
In respect of:				
Loans and advances to banks		1		18
Loans and advances to customers		1,408		1,419
	<u>1,409</u>		<u>1,437</u>	
	Group		Bank	
	2004	2003	2004	2003
	£m	£m	£m	£m
Non-performing lending comprises:				
Accruing loans on which interest is being placed in suspense	567	633	332	396
Loans accounted for on a non-accrual basis	673	585	671	581
	<u>1,240</u>	<u>1,218</u>	<u>1,003</u>	<u>977</u>
Provisions	(914)	(916)	(707)	(737)
Interest held in suspense	(21)	(28)	(9)	(15)
	<u>305</u>	<u>274</u>	<u>287</u>	<u>225</u>

15 Concentrations of exposure

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Loans and advances to customers:				
<i>Domestic:</i>				
Agriculture, forestry and fishing	2,076	2,025	720	684
Manufacturing	3,292	3,211	2,611	2,680
Construction	1,877	1,497	1,658	1,308
Transport, distribution and hotels	6,753	4,741	5,815	3,980
Property companies	5,775	4,577	5,122	4,118
Financial, business and other services	12,103	9,652	10,108	7,424
Personal: mortgages	80,065	70,750	338	333
: other	22,833	20,139	19,056	16,990
Lease financing	6,387	6,470	–	–
Hire purchase	4,828	4,701	176	58
Due from fellow group undertakings	1,741	1,766	25,833	28,083
Other	5,321	3,351	3,492	3,025
Total domestic	153,051	132,880	74,929	68,683
<i>International:</i>				
Latin America	125	557	125	410
USA	2,385	2,681	1,985	2,295
Europe	1,587	1,981	1,587	1,981
Rest of the world	516	623	500	493
Total international	4,613	5,842	4,197	5,179
	<u>157,664</u>	<u>138,722</u>	<u>79,126</u>	<u>73,862</u>
Provisions for bad and doubtful debts*	(1,662)	(1,677)	(1,408)	(1,419)
Interest held in suspense*	(21)	(28)	(9)	(15)
	<u>155,981</u>	<u>137,017</u>	<u>77,709</u>	<u>72,428</u>

*Figures exclude provisions and interest held in suspense relating to loans and advances to banks.

The classification of lending as domestic or international is based on the location of the office recording the transaction, except for certain lending of the international business booked in London.

Notes to the accounts

16 Debt securities	2004	2004	2003	2003	16 Debt securities (continued)	Cost	Premiums	Provisions	Total
	Balance sheet £m	Valuation £m	Balance sheet £m	Valuation £m			and discounts £m		
Group					Movements in investment securities comprise:				
Investment securities:					At 1 January 2004	13,731	109	99	13,741
Government securities	2,211	2,213	1,895	1,902	Exchange and other adjustments	(484)	–	(2)	(482)
Bank and building society certificates of deposit	1,901	1,902	2,515	2,515	Additions	9,637	–	–	9,637
Corporate debt securities	2,581	2,587	1,895	1,890	Transfers from other securities	281	–	–	281
Mortgage backed securities	2,774	2,781	2,211	2,212	Securities sold or matured	(8,787)	(2)	(25)	(8,764)
Other asset backed securities	3,761	3,756	3,942	3,951	Adjustments on disposal of businesses	(23)	–	(7)	(16)
Other debt securities	1,140	1,141	1,283	1,284	Charge for the year	–	–	43	(43)
	14,368	14,380	13,741	13,754	Amortisation of premiums and discounts	–	14	–	14
Other securities:					At 31 December 2004	14,355	121	108	14,368
Government securities	4,524	4,524	7,253	7,253					
Other public sector securities	51	51	106	106					
Corporate debt securities	5,733	5,733	6,785	6,785					
Mortgage backed securities	504	504	664	664					
Other asset backed securities	14	14	120	120					
	25,194	25,206	28,669	28,682					
Due within 1 year	4,090		5,045						
Due 1 year and over	21,104		23,624						
	25,194		28,669						
Geographical analysis by issuer:									
United Kingdom	5,048		5,232						
Other European	11,825		15,949						
North America and Caribbean	5,080		5,130						
Latin America	76		98						
Asia Pacific	2,763		1,994						
Other	402		266						
	25,194		28,669						
Unamortised discounts net of premiums on investment securities	56		341						
Investment securities:									
Listed	8,925	8,931	8,162	8,173					
Unlisted	5,443	5,449	5,579	5,581					
	14,368	14,380	13,741	13,754					
Other securities:									
Listed	10,378	10,378	14,374	14,374					
Unlisted	448	448	554	554					
	10,826	10,826	14,928	14,928					

	2004	2004	2003	2003
	Balance sheet £m	Valuation £m	Balance sheet £m	Valuation £m
Bank				
Investment securities:				
Government securities	1,680	1,680	1,372	1,378
Bank and building society certificates of deposit	1,547	1,547	2,101	2,101
Corporate debt securities	172	176	90	87
Mortgage backed securities	927	928	13	13
Other asset backed securities	880	876	343	351
Other debt securities	499	500	711	711
	5,705	5,707	4,630	4,641
Other securities:				
Government securities	4,524	4,524	7,253	7,253
Other public sector securities	51	51	106	106
Corporate debt securities	5,733	5,733	6,785	6,785
Mortgage backed securities	504	504	664	664
Other asset backed securities	14	14	120	120
	16,531	16,533	19,558	19,569
Due within 1 year	3,287		4,521	
Due 1 year and over	13,244		15,037	
	16,531		19,558	
Geographical analysis by issuer:				
United Kingdom	3,046		2,871	
Other European	8,930		12,197	
North America and Caribbean	3,270		3,513	
Latin America	74		96	
Asia Pacific	873		617	
Other	338		264	
	16,531		19,558	
Unamortised discounts net of premiums on investment securities	1		1	

Notes to the accounts

16 Debt securities (continued)	2004	2004	2003	2003
	Balance sheet £m	Valuation £m	Balance sheet £m	Valuation £m
Investment securities:				
Listed	2,600	2,598	915	925
Unlisted	3,105	3,109	3,715	3,716
	5,705	5,707	4,630	4,641
Other securities:				
Listed	10,378	10,378	14,374	14,374
Unlisted	448	448	554	554
	10,826	10,826	14,928	14,928

Movements in investment securities comprise:	Cost £m	Premiums and discounts	Provisions £m	Total £m
		£m		
At 1 January 2004	4,668	–	38	4,630
Exchange and other adjustments	(181)	–	(2)	(179)
Additions	8,985	–	–	8,985
Transfers from other securities	162	–	–	162
Adjustments on disposal of businesses	(22)	–	(7)	(15)
Securities sold or matured	(7,878)	(1)	–	(7,879)
Amortisation of premiums and discounts	–	1	–	1
At 31 December 2004	5,734	–	29	5,705

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. It is expected that tax of £4 million (2003: £3 million) would be payable if the Group's investment securities were sold at their year end valuation.

The difference between the cost of other securities and market value, where the market value is higher than the cost, is not disclosed as its determination is not practicable.

17 Equity shares	2004	2004	2003	2003
	Balance sheet £m	Valuation £m	Balance sheet £m	Valuation £m
Group				
Investment securities:				
Listed	5	7	5	5
Unlisted	34	56	30	126
	39	63	35	131
Other securities:				
Listed	176	176	423	423
	215	239	458	554

Movements in investment securities comprise:	Cost £m	Provisions £m	Total £m
At 1 January 2004	41	6	35
Exchange and other adjustments	(1)	(1)	–
Additions	21	–	21
Disposals	(12)	(5)	(7)
Adjustments on disposal of businesses	(1)	–	(1)
Charge for the year	–	9	(9)
At 31 December 2004	48	9	39

Bank	2004	2004	2003	2003
	Balance sheet £m	Valuation £m	Balance sheet £m	Valuation £m
Investment securities:				
Unlisted	17	37	16	21
Other securities:				
Listed	–	–	248	248
	17	37	264	269

Movements in investment securities comprise:	Cost £m
At 1 January 2004	16
Additions	1
At 31 December 2004	17

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. If the Group's investment securities were sold at their year end valuation no tax is expected to be payable as any such gains would be exempt or covered by available capital losses.

The difference between the cost of other securities and market value, where the market value is higher than the cost, is not disclosed as its determination is not practicable.

Notes to the accounts

18 Assets transferred under sale and repurchase transactions

Assets subject to sale and repurchase agreements are as follows:

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Treasury bills and other eligible bills	117	136	117	132
Debt securities	10,454	4,503	9,050	2,926
	10,571	4,639	9,167	3,058

These investments have been sold to third parties but the Group is committed to reacquire them at a future date and at a predetermined price. At 31 December 2004, the Group held £12,783 million (2003: £2,643 million) of securities as collateral under reverse repurchase agreements. The above disclosure includes assets held through these agreements and subsequently resold as collateral for the Group's own transactions.

19 Interests in joint ventures

	Group £m	Bank £m
At 1 January 2004	54	36
Amounts provided in year	–	(24)
Revaluations	–	23
Losses for the year	(1)	–
At 31 December 2004	53	35

The Group's and the Bank's largest investments are in two joint ventures:

	Group interest	Nature of business
iPSL	19.5% of issued ordinary share capital	Cheque processing
GF Two Limited (formerly Goldfish Holdings Limited)	25.0% of issued ordinary share capital	Financial services

In the year ended 31 December 2004 £16 million (2003: £25 million) of fees payable to iPSL have been included in the Group's administrative expenses and £3 million (2003: £3 million) of charges to iPSL have been included in the Group's income. The Group has also prepaid £17 million (2003: £13 million) of fees in respect of 2005 and this amount is included in prepayments and accrued income.

GF One Limited (formerly Goldfish Bank Limited, a wholly owned subsidiary of GF Two Limited) has lent £44 million (2003: nil) to the Bank and this amount is included in customer accounts. Interest payable to GF One Limited of £1 million (2003: nil) has been charged to the Group's profit and loss account and capitalised in this balance. In the year ended 31 December 2003 £7 million of interest receivable from GF One Limited and £6 million of charges to GF One Limited in respect of administrative costs were included in the Group's income.

On a historical cost basis, the Bank's interests in associated undertakings and joint ventures would have been included at £54 million (2003: £78 million).

Included in the gross assets disclosed on the balance sheet is an investment of £3 million (2003: £3 million) in associated undertakings.

20 Shares in group undertakings

	Bank £m	2003 £m
At 1 January 2004	19,805	
Additions	2	
Capital injections	1,371	
Disposals	(14)	
Amounts provided in year	(169)	
Revaluations	439	
At 31 December 2004	21,434	
	2004 £m	2003 £m
Shares in banks	2,955	2,942
Shares in other group undertakings	18,479	16,863
Total – all unlisted	21,434	19,805

On a historical cost basis, shares in group undertakings would have been included as follows:

	Cost £m	Provisions £m	Book value £m
At 1 January 2004	16,412	15	16,397
Additions	2	–	2
Capital injections	1,371	–	1,371
Disposals	(5)	–	(5)
Amounts provided in year	–	169	(169)
At 31 December 2004	17,780	184	17,596

No deferred tax provision has been made against the liability which could arise if group undertakings were disposed of at their balance sheet carrying value because of surplus capital losses and the exemptions for disposals of substantial shareholding investments.

The principal group undertakings, all of which have prepared accounts to 31 December and whose results are included in the consolidated accounts of Lloyds TSB Bank plc, are:

	Country of registration/incorporation	Percentage of equity share capital and voting rights held	Nature of business
Cheltenham & Gloucester plc	England	100%*	Mortgage lending and retail investments
Lloyds TSB Commercial Finance Limited	England	100%	Credit factoring
Lloyds TSB Leasing Limited	England	100%	Financial leasing
The Agricultural Mortgage Corporation PLC	England	100%	Long-term agricultural finance
Lloyds TSB Offshore Limited	Jersey	100%*	Banking and financial services
Lloyds TSB Asset Finance Division Limited	England	100%	Consumer credit, leasing and related services
Black Horse Limited	England	100%*	Consumer credit, leasing and related services
Lloyds TSB Private Banking Limited	England	100%	Private banking
Lloyds TSB Scotland plc	Scotland	100%	Banking and financial services
Lloyds TSB General Insurance Limited	England	100%*	General insurance
Scottish Widows Investment Partnership Group Limited	England	100%*	Investment management
Abbey Life Assurance Company Limited	England	100%*	Life assurance
Lloyds TSB Insurance Services Limited	England	100%*	Insurance broking
Scottish Widows plc	Scotland	100%*	Life assurance
Scottish Widows Annuities Limited	Scotland	100%*	Life assurance

*Indirect interest.

The country of registration/incorporation is also the principal area of operation for each of the above group undertakings.

Notes to the accounts

21 Quasi-subidiaries

The Group has interests in a number of entities which, although they do not meet the legal definition of a subsidiary, give rise to benefits that are in substance no different from those that would arise if those entities were subsidiaries. As a consequence, these entities are consolidated in the same way as if they were subsidiaries.

The primary financial statements of these entities can be summarised as follows:

	Equipment leasing vehicles		Structured finance vehicles	
	2004 £m	2003 £m	2004 £m	2003 £m
Profit and loss account				
Interest receivable	–	–	132	82
Interest payable	(74)	(59)	(83)	(52)
Other operating income	116	93	(8)	(2)
Total income	42	34	41	28
Operating expenses	(57)	(36)	–	–
(Loss) profit on ordinary activities before taxation	(15)	(2)	41	28
Tax on (loss) profit on ordinary activities	5	6	(5)	(2)
(Loss) profit on ordinary activities after taxation	(10)	4	36	26
Dividends paid	–	–	(24)	–
(Loss) profit for the year	(10)	4	12	26
Balance sheet				
<i>Assets</i>				
Loans and advances to customers	–	–	410	345
Debt securities	–	–	3,770	3,718
Tangible fixed assets	1,742	1,408	–	–
Other assets and prepayments	49	23	36	34
Total assets	1,791	1,431	4,216	4,097
<i>Liabilities</i>				
Deposits by banks	1,527	1,309	–	672
Debt securities in issue	–	–	3,272	3,123
Other liabilities and accruals	260	108	31	18
Shareholders' funds	4	14	913	284
Total liabilities	1,791	1,431	4,216	4,097
Cash flow statement				
Net cash inflow from operating activities	388	132	52	1,173

22 Intangible fixed assets

Group	Cost Amortisation		Net book value
	£m	£m	
Positive goodwill:			
At 1 January 2004	2,618	111	2,507
Acquisition adjustments	(28)	–	(28)
Adjustments on disposal of businesses	(14)	(4)	(10)
Charge for the year	–	44	(44)
At 31 December 2004	2,576	151	2,425
Negative goodwill:			
At 1 January 2004 and 31 December 2004	23	23	–
Bank			
Positive goodwill:			
At 1 January 2004	124	6	118
Adjustments on disposal of businesses	(1)	(1)	–
Charge for the year	–	11	(11)
At 31 December 2004	123	16	107

23 Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m
Group			
Cost:			
At 1 January 2004	1,191	2,184	2,518
Exchange and other adjustments	1	1	(46)
Disposal of businesses	(10)	(13)	–
Additions	73	262	801
Disposals	(18)	(109)	(471)
At 31 December 2004	1,237	2,325	2,802
Depreciation:			
At 1 January 2004	416	1,295	266
Exchange and other adjustments	–	–	(4)
Disposal of businesses	(4)	(8)	–
Charge for the year (£589 million in total; 2003: £646 million)	66	257	266
Disposals	(5)	(81)	(281)
At 31 December 2004	473	1,463	247
Balance sheet amount at 31 December 2004	764	862	2,555
		4,181	
Balance sheet amount at 31 December 2003	775	889	2,252
		3,916	
Bank			
Cost:			
At 1 January 2004		891	1,806
Exchange and other adjustments		(1)	(1)
Disposal of businesses		(7)	(3)
Additions		62	232
Disposals		(12)	(74)
At 31 December 2004		933	1,960
Depreciation:			
At 1 January 2004		384	1,016
Exchange and other adjustments		(1)	–
Disposal of businesses		(3)	–
Charge for the year		57	217
Disposals		(4)	(62)
At 31 December 2004		433	1,171
Balance sheet amount at 31 December 2004		500	789
		1,289	
Balance sheet amount at 31 December 2003		507	790
		1,297	

Notes to the accounts

23 Tangible fixed assets (continued)

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Balance sheet amount of premises comprises:				
Freeholds	349	368	215	225
Leaseholds 50 years and over unexpired	140	133	32	27
Leaseholds less than 50 years unexpired	275	274	253	255
	764	775	500	507
Land and buildings occupied for own activities	695	705	443	450
The Group's residual value exposure in respect of operating lease assets, all of which are expected to be disposed of at the end of the lease terms, was as follows:				
Residual value expected to be recovered in:			2004 £m	2003 £m
1 year or less			378	181
2 years or less but over 1 year			128	330
5 years or less but over 2 years			647	505
Over 5 years			588	445
Total exposure			1,741	1,461

24 Lease commitments

Annual commitments under non-cancellable operating lease agreements in respect of premises were:

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Leases on which the commitment is due to expire in:				
1 year or less	6	7	5	6
5 years or less but over 1 year	26	29	22	27
Over 5 years	176	190	160	174
	208	226	187	207
	2004 Premises £m	2004 Equipment £m	2003 Premises £m	2003 Equipment £m
Obligations under finance leases were:				
Group				
Amounts payable in:				
1 year or less	1	1	–	–
5 years or less but over 1 year	3	1	–	–
	4	2	–	–
Bank				
Amounts payable in:				
1 year or less	1	–	–	–
5 years or less but over 1 year	3	1	–	–
	4	1	–	–

25 Capital commitments

Capital expenditure contracted but not provided for at 31 December 2004 amounted to £150 million for the Group and £4 million for the Bank (2003: Group £77 million; Bank £6 million). Of the capital commitments of the Group, £146 million (2003: £71 million) relates to assets to be leased to customers under operating leases.

26 Other assets

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Balances arising from derivatives used for trading purposes (note 47a)	2,015	2,489	2,443	2,937
Balances arising from derivatives used for hedging purposes	254	475	–	27
Settlement balances	40	54	1	13
Other assets	892	907	504	478
	3,201	3,925	2,948	3,455

27 Prepayments and accrued income

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Interest receivable	1,075	869	1,529	1,179
Deferred expenditure incurred under cash gift and discount mortgage schemes	78	128	–	–
Other debtors and prepayments	1,431	931	342	405
	2,584	1,928	1,871	1,584

Notes to the accounts

28 Long-term assurance business**a Analysis of embedded value**

The embedded value included in the consolidated balance sheet comprises:

	2004 £m	2003 £m
Net tangible assets of life companies including surplus	3,857	3,617
Value of other shareholder's interests in the long-term assurance business	2,939	2,879
	6,796	6,496

Movements in the embedded value balance have been as follows:

	2004 £m	2003 £m
At 1 January	6,496	6,228
Exchange and other adjustments	(16)	12
Profit after tax	516	296
Adjustments on disposal of businesses	-	(38)
Dividends	(200)	(2)
At 31 December	6,796	6,496

b Analysis of income from long-term assurance business

Income from long-term assurance business included in the profit and loss account can be divided into those items comprising the operating profit of the business and other items. Included within operating profit are the following items:

New business contribution: this represents the value recognised at the end of the year from new business written during the year after taking into account the cost of establishing technical provisions and reserves, less the costs of acquiring the business, including commissions paid to independent financial advisers and other direct sales costs.

Contribution from existing business: this comprises the following elements:

- the expected return arising from the unwinding of the discount applied to the expected cash flows at the beginning of the year;
- experience variances caused by the differences between the actual experience during the year and the expected experience;
- the effects of changes in assumptions, other than economic assumptions, and other items; and
- customer remediation provisions (see c).

Development costs: this represents the costs associated with new product development and implementation of the bancassurance strategy.

Investment earnings: this represents the expected investment return on both the net tangible assets and the value of the shareholder's interest in the long-term business account, based upon the economic assumptions made at the beginning of the year.

Operating profit is adjusted by the following items to arrive at income from long-term assurance business:

Investment variance: this represents (a) the difference between the actual investment return in the year on investments backing shareholder funds and the expected return based upon the economic assumptions made at the beginning of the year; (b) the effect of these fluctuations on the value of in-force business; and (c) other effects of changes in extraneous economic circumstances beyond the control of management.

28 Long-term assurance business (continued)

Changes in economic assumptions: this represents the effect of changes in the economic assumptions referred to in e.

Income from long-term assurance business is set out below:

	2004 £m	2003 £m
New business contribution	225	150
Existing business:		
Expected return	289	264
Experience variances	(41)	(16)
Assumption changes and other items	(39)	(75)
Customer remediation provisions (see c)	(12)	(100)
	197	73
Development costs	(11)	(13)
Investment earnings	167	153
Operating profit	578	363
Investment variance	139	112
Changes in economic assumptions (see e)	(2)	(22)
Income from long-term assurance business before tax	715	453
Attributed tax	(199)	(157)
Income from long-term assurance business after tax	516	296

c Customer remediation provisions*Redress to past purchasers of pension policies*

Following an industry wide investigation in the 1990's it was concluded that a large number of customers who had purchased personal pension products had been poorly advised by insurance companies and intermediaries; an action plan was established requiring the UK pensions industry to review all cases of possible misselling and, where appropriate, pay compensation. As the review of pension cases in the Group has progressed, provisions have been established for the estimated cost of compensation.

Movements in the provision over the last two years have been as follows:

	2004 £m	2003 £m
At 1 January	25	37
Accrual of interest on the provision	-	2
Charge for the year	-	44
Compensation paid	(12)	(58)
At 31 December	13	25

The review is now nearing completion and management do not expect any further material changes in the provisioning requirement.

Notes to the accounts

28 Long-term assurance business (continued)*Mortgage endowments and other savings products*

During 2002, a review was carried out in conjunction with the FSA into sales of mortgage endowment and other long-term savings products made by the Abbey Life sales force between 1988 and its disposal by Lloyds TSB Group in February 2000. As a result of this review, the Group is required to pay compensation to customers in those cases where sales practices are found to have been deficient. A provision has been established to meet the cost of the payments to those customers; a provision is also held against the estimated cost of redress payments to customers in respect of products sold by the Abbey Life sales force prior to 1988. During 2004 management has reviewed the adequacy of the provisions held in the light of experience and changing market conditions and an additional charge of £12 million (2003: £56 million) has been made.

Movements in the provision over the last two years have been as follows:

	2004 £m	2003 £m
At 1 January	149	165
Accrual of interest on the provision	3	5
Charge for the year	12	56
Compensation paid	(140)	(77)
At 31 December	<u>24</u>	<u>149</u>

Details of the provisions held in respect of the estimated cost of making redress payments to customers in respect of past product sales by the Group's banking operations are given in note 36.

d With-profits options and guarantees

In common with other organisations in the life assurance industry, prior to its demutualisation Scottish Widows wrote policies which contained potentially valuable options and guarantees, including guaranteed annuity option policies. Under the terms of transfer of the Scottish Widows business, a separate memorandum account was created within the With-Profits Fund called the Additional Account, which is available, inter alia, to meet any additional costs of providing guaranteed benefits on transferred policies; the Additional Account had a value at 31 December 2004 of £1.4 billion (2003: £1.4 billion). To the extent that the Additional Account is insufficient to provide these benefits any shortfall would be met by the Group.

28 Long-term assurance business (continued)

Since demutualisation in 2000, Scottish Widows continued to write policies containing similar features, although the volume of products written has since reduced and is now not significant. The Additional Account is not available to meet any additional cost of providing the benefits on these policies.

The eventual cost of providing benefits on the policies written both pre and post demutualisation is dependent upon a large number of variables, including in particular:

- future interest rate and equity market trends;
- demographic factors, such as future persistency and mortality; and
- the proportion of policyholders who seek to exercise their options.

The ultimate cost, and any impact upon the Group, will not be known for many years. However, Scottish Widows has developed, and will continue to develop, an actuarial model to assist in the management of the With-Profits Fund and to meet regulatory requirements. The model allows management to estimate the effects of different economic scenarios upon the financial position of the fund and consider the implications of different management actions. Output from this model indicates that the possible cost of providing benefits on policies containing features such as options and guarantees varies widely and, depending on the economic scenario encountered, could result in the Group incurring a liability. Based on the information available at present, having considered the range of possible outcomes, and after making allowance for the effect of proposed future management actions, the Group currently considers that no provision is necessary. However, the model is subject to ongoing development and the position will be kept under review.

Notes to the accounts

28 Long-term assurance business (continued)**e Assumptions**

In accordance with the Association of British Insurers' detailed guidance for the preparation of figures using the achieved profits method of accounting, the Group has reviewed the economic assumptions used in the embedded value calculations. The guidance requires that the assumptions should be reviewed at each reporting date.

The principal economic assumptions have been revised at 31 December 2004 as follows:

	2004 %	2003 %
Risk-adjusted discount rate (net of tax)	7.40	7.60
Return on equities (gross of tax)	7.17	7.45
Return on fixed interest securities (gross of tax)	4.57	4.85
Expenses inflation	3.76	3.80

The revised assumptions have resulted in a net charge to the profit and loss account of £2 million.

Other assumptions used to derive the embedded value are as follows:

- Assumed rates of mortality and morbidity are taken from published tables adjusted for demographic differences. Assumptions in respect of lapse rates take into account both the effect of recent actual experience and future expectations of the companies concerned.
- Current tax legislation and rates have been assumed to continue unaltered, except where future changes have been announced. The UK corporation tax rate used for grossing up was 30 per cent (2003: 30 per cent). The normalised investment earnings have been grossed up at a composite longer term tax rate of 18 per cent (2003: 17 per cent).
- The value of the in-force business does not allow for future premiums under recurring single premium business or non-contractual increments, which are included in new business when the premium is received. Department of Social Security rebates have been treated as recurring single premiums.
- Future bonus rates on with-profits business are set at levels which would fully utilise the assets supporting the with-profits business. The proportion of profits derived from with-profits business allocated to the shareholder has been assumed to continue at the current rate of one-ninth of the cost of the eligible bonus, in accordance with the terms of the transfer of the Scottish Widows business.

f Sensitivities

The table below shows the effect on both the embedded value at 31 December 2004 and the new business contribution for the year then ended of theoretical changes in the main economic assumptions:

	Embedded value £m	New business contribution £m
As published	6,796	225
Effect of a 1% increase in the discount rate	(189)	(26)
Effect of a 1% reduction in the discount rate	213	30
Effect of a 1% reduction in the return on equities	(84)	(12)

28 Long-term assurance business (continued)**g Balance sheet**

The long-term assurance assets attributable to policyholders comprise:

	2004 £m	2003 £m
Investments	56,975	52,097
Premises and equipment	35	40
Other assets	1,741	1,680
	58,751	53,817
Net tangible assets of life companies including surplus	(3,857)	(3,617)
	54,894	50,200
Investments shown above comprise:		
Fixed interest securities	15,985	15,947
Stocks, shares and unit trusts	31,911	27,605
Investment properties	3,150	3,540
Other properties	120	121
Mortgages and loans	76	65
Deposits	5,733	4,819
	56,975	52,097

The liabilities to policyholders comprise:

Technical provisions:		
Long-term business provision (net of reinsurance)	23,705	23,730
Claims outstanding (net of reinsurance)	246	238
Technical provisions for linked liabilities	28,256	25,023
Fund for future appropriations	1,379	346
Other liabilities	1,308	863
	54,894	50,200

h Disclosures on a modified statutory solvency basis

The individual statutory accounts of the Group's life assurance subsidiaries are prepared under the modified statutory solvency basis, in the same way as the statutory accounts of listed insurance groups in the UK. The principal difference between the modified statutory solvency basis and the embedded value basis used for the preparation of the Group's accounts is that accounts prepared under the modified statutory solvency basis do not reflect the value of in-force business.

Under the modified statutory solvency basis, the results of the Group's long-term life and pensions businesses were as follows:

	2004 £m	2003 £m
Premiums	5,575	5,139
Investment income	1,981	2,073
Unrealised gains on investments	2,815	4,833
Other income	-	6
	10,371	12,051
Claims	(5,222)	(4,433)
Change in technical provisions	(3,208)	(4,540)
Expenses	(535)	(689)
Realised gains (losses) on investments	244	(1,679)
Unrealised losses on investments	-	(22)
Other charges	-	(4)
Tax attributable to long-term business	(110)	(41)
Transfer to the fund for future appropriations	(1,084)	(414)
Balance on the technical account – long-term business	456	229
Tax attributable to balance on the technical account – long-term business	155	112
Income in shareholder fund	55	34
Profit on ordinary activities before tax	666	375
Tax on profit on ordinary activities	(170)	(125)
Profit on ordinary activities after tax	496	250
Dividends proposed	(200)	-
Profit for the financial year	296	250

Notes to the accounts

28 Long-term assurance business (continued)

Income from long-term assurance business after tax reconciles to the profit calculated on a modified statutory solvency basis as follows:

	2004 £m	2003 £m
Income from long-term assurance business attributable to the shareholder after tax	516	296
Increase in value-in-force taken to profit	(60)	(2)
	<u>456</u>	<u>294</u>
Other differences:		
– movement in deferred acquisition costs	89	66
– tax adjustment	7	(60)
– other	(56)	(50)
	<u>496</u>	<u>250</u>
Profit on ordinary activities after tax – modified statutory solvency basis	<u>496</u>	<u>250</u>

A summarised balance sheet on a modified statutory solvency basis was as follows:

	2004 £m	2003 £m
Assets		
Investments	29,084	27,483
Assets held to cover linked liabilities	28,256	25,023
Other assets	1,992	2,018
Total assets	<u>59,332</u>	<u>54,524</u>
Liabilities		
Shareholder's funds	4,596	4,249
Fund for future appropriations	1,379	346
Long-term business provision†	23,705	23,730
Technical provision for linked liabilities†	28,256	25,023
Other creditors	1,396	1,176
Total liabilities	<u>59,332</u>	<u>54,524</u>

†Net of reinsurers' share of technical provisions

The value of long-term business attributable to the shareholder on an embedded value basis reconciles to the net assets of the Group's life and pensions subsidiaries calculated on a modified statutory solvency basis as follows:

	2004 £m	2003 £m
Long-term assurance business attributable to the shareholder – embedded value basis	6,796	6,496
Value of in-force business	(2,939)	(2,879)
	<u>3,857</u>	<u>3,617</u>
Other differences:		
– deferred acquisition costs	585	496
– tax adjustment	152	145
– other adjustments	2	(9)
	<u>4,596</u>	<u>4,249</u>
Net tangible assets of life operations – modified statutory solvency basis	<u>4,596</u>	<u>4,249</u>

29 Assets and liabilities denominated in foreign currencies

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Assets: denominated in sterling	173,452	155,539	152,856	139,392
: denominated in other currencies	53,375	48,159	51,467	45,161
	<u>226,827</u>	<u>203,698</u>	<u>204,323</u>	<u>184,553</u>
Liabilities: denominated in sterling	173,335	155,533	152,764	139,383
: denominated in other currencies	53,492	48,165	51,559	45,170
	<u>226,827</u>	<u>203,698</u>	<u>204,323</u>	<u>184,553</u>

Assets and liabilities exclude long-term assurance assets attributable to policyholders and liabilities to policyholders.

30 Deposits by banks

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Repayable on demand	5,183	7,455	8,997	11,020
Other deposits by banks with agreed maturity dates or periods of notice by residual maturity repayable:				
3 months or less	31,833	15,002	33,441	16,469
1 year or less but over 3 months	2,500	1,197	3,866	1,492
5 years or less but over 1 year	21	69	1,264	1,048
Over 5 years	201	232	–	182
	<u>39,738</u>	<u>23,955</u>	<u>47,568</u>	<u>30,211</u>
Included above:				
Due to group undertakings			8,738	7,030

31 Customer accounts

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Repayable on demand	94,138	90,987	74,661	74,977
Other customer accounts with agreed maturity dates or periods of notice by residual maturity repayable:				
3 months or less	18,938	17,316	16,431	16,595
1 year or less but over 3 months	2,442	1,846	2,100	1,877
5 years or less but over 1 year	5,632	5,431	5,268	4,258
Over 5 years	1,204	1,364	2,248	2,434
	<u>122,354</u>	<u>116,944</u>	<u>100,708</u>	<u>100,141</u>
Included above:				
Due to group undertakings			10,141	13,980
Due to fellow group undertakings	292	448	218	376

Notes to the accounts

32 Debt securities in issue	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Bonds and medium-term notes by residual maturity repayable:				
1 year or less	167	711	167	711
2 year or less but over 1 year	144	81	144	81
5 years or less but over 2 years	1,053	1,099	787	769
Over 5 years	3,999	3,623	3,999	3,623
	5,363	5,514	5,097	5,184
Other debt securities by residual maturity repayable:				
3 months or less	18,489	17,942	15,114	14,729
1 year or less but over 3 months	2,941	2,015	2,928	1,982
5 years or less but over 1 year	424	283	268	265
Over 5 years	-	168	-	-
	21,854	20,408	18,310	16,976
	27,217	25,922	23,407	22,160

33 Other liabilities	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Balances arising from derivatives used for trading purposes (note 47a)	3,343	3,719	3,692	4,002
Balances arising from derivatives used for hedging purposes	525	283	423	-
Current tax	380	317	136	(49)
Dividends	1,314	1,314	1,314	1,314
Settlement balances	38	40	3	3
Other liabilities	970	1,116	682	781
	6,570	6,789	6,250	6,051

34 Accruals and deferred income	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Interest payable	1,530	1,165	1,540	1,222
Other creditors and accruals	2,382	2,077	725	913
	3,912	3,242	2,265	2,135

35 Deferred tax	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Short-term timing differences	(193)	(222)	(169)	(197)
Accelerated depreciation allowances	1,669	1,605	38	9
	1,476	1,383	(131)	(188)
		Group £m		Bank £m
At 1 January 2004		1,383		(188)
Exchange and other adjustments		(27)		-
Adjustments on disposal of assets		(22)		-
Charge for the year		142		57
At 31 December 2004		1,476		(131)

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in the future has been entered into. Deferred tax balances have not been discounted.

The deferred tax balance at 31 December 2004 for the Group does not include any amounts in respect of the Group's post-retirement benefit liability which is shown on the balance sheet after deduction of a deferred tax asset of £956 million (2003: £916 million) (note 45).

36 Other provisions for liabilities and charges

Group	Customer remediation provisions £m	Insurance provisions £m	Vacant leasehold property and other £m	Total £m
	At 1 January 2004	97	219	86
Exchange and other adjustments	-	(6)	-	(6)
Adjustments on disposal	-	-	(1)	(1)
Provisions applied	(105)	(203)	(13)	(321)
Charge for the year	100	224	19	343
At 31 December 2004	92	234	91	417
Bank				
At 1 January 2004	67	-	75	142
Provisions applied	(87)	-	(12)	(99)
Charge for the year	100	-	17	117
At 31 December 2004	80	-	80	160

Customer remediation provisions

The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, where the original sales processes are found to have been deficient. During 2004 management have again reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made and as a result an additional charge of £100 million (2003: £200m) has been made.

At 31 December 2004 the provisions held mainly related to past sales of mortgage endowment policies. Mortgage endowments were sold to customers through the branch network of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester, and underwritten by life assurance companies within the Group and also by third parties.

Notes to the accounts

36 Other provisions for liabilities and charges (continued)

The principal assumptions that have been made in the calculation of the provision relate to the number of cases that are likely to require redress and the estimated average cost per case. The ultimate cost and timing of the payments remains highly uncertain and will be influenced by external factors beyond the control of management, such as regulatory actions, media interest and the performance of the financial markets. However, it is expected that the majority of the expenditure will be incurred over the next two years.

Insurance provisions

The Group's general insurance subsidiary maintains provisions for outstanding claims which represent the ultimate cost of settling all claims arising from events which have occurred up to the balance sheet date and these include provisions for the cost of claims notified but not settled and for claims incurred but not yet reported. In addition, in line with the requirements of the Insurance Companies (Reserves) Act 1995, a claims equalisation provision is maintained in relation to property business. The majority of provisions in respect of claims will be settled in the following year, although new provisions will then be required in respect of claims arising from that year. The level of the claims equalisation provision will be adjusted annually, taking into account the guidelines contained in the legislation, and such provisions will be held for as long as the Group continues to write the relevant types of general insurance business.

The Group also carries provisions in respect of its obligations relating to UIC Insurance Company Limited ('UIC'), which is partly owned by the Group. The Group has indemnified a third party against losses in the event that UIC does not honour its obligations under a reinsurance contract, which is subject to asbestosis and pollution claims in the US. The ultimate exposure to claims in respect of the insurance business of UIC is uncertain. Accordingly, the provision has been based upon an actuarial estimate of prospective claims, taking account of reinsurance arrangements protecting UIC and UIC's available assets. Given the long-term nature of many of the claims to which UIC is exposed, it is expected to be many years before the Group's ultimate liability can be assessed with certainty.

Vacant leasehold property and other

Vacant leasehold property provisions are made by reference to a prudent estimate of expected sub-let income and the possibility of disposing of the Group's interest in the lease, taking into account conditions in the property market. These provisions are reassessed on an annual basis and will run off during the remaining life of the leases concerned, the run off period currently averages 5 years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

Notes to the accounts

37 Subordinated liabilities

	Notes	Group		Bank	
		2004 £m	2003 £m	2004 £m	2003 £m
<i>Undated loan capital*†:</i>					
Primary Capital Undated Floating Rate Notes:	a				
Series 1 (US\$750 million)		389	419	389	419
Series 2 (US\$500 million)		259	279	259	279
Series 3 (US\$600 million)		311	335	311	335
11 ³ / ₄ % Perpetual Subordinated Bonds		100	100	–	–
6.625% Perpetual Capital Securities (€750 million)	b	526	523	526	523
6.90% Perpetual Capital Securities callable 2007 (US\$1,000 million)	c	512	550	512	550
5 ⁵ / ₈ % Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	f	877	874	877	874
Undated Step-up Floating Rate Notes callable 2009 (€150 million)	a	105	105	105	105
6 ⁵ / ₈ % Undated Subordinated Step-up Notes callable 2010	e	407	407	407	407
7.375% Undated Subordinated Step-up Notes callable 2012 (€430 million)		–	–	302	301
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	d, f	350	349	350	349
7.834% Undated Subordinated Step-up Notes callable 2015		–	–	248	248
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20 billion)	g	101	104	101	104
5.125% Undated Subordinated Step-up Notes callable 2016		497	496	497	496
6 ¹ / ₂ % Undated Subordinated Step-up Notes callable 2019	e	267	267	267	267
8% Undated Subordinated Step-up Notes callable 2023	e	199	199	199	199
6 ¹ / ₂ % Undated Subordinated Step-up Notes callable 2029	e	455	455	455	455
6% Undated Subordinated Step-up Bonds callable 2032	e	500	500	500	500
		5,855	5,962	6,305	6,411
<i>Dated loan capital:</i>					
Subordinated Floating Rate Notes 2004		–	5	–	–
7 ³ / ₈ % Subordinated Bonds 2004		–	400	–	400
Subordinated Floating Rate Notes 2004		–	100	–	100
7 ³ / ₄ % Subordinated Bonds 2007		299	299	299	299
5 ¹ / ₄ % Subordinated Notes 2008 (DM750 million)		270	269	270	269
10 ⁵ / ₈ % Guaranteed Subordinated Loan Stock 2008		107	108	107	108
9 ¹ / ₂ % Subordinated Bonds 2009		100	100	100	100
Subordinated Step-up Floating Rate Notes 2009 callable 2004 (US\$500 million)		–	279	–	279
6 ¹ / ₄ % Subordinated Notes 2010 (€400 million)		281	281	281	281
Subordinated Floating Rate Notes 2010 (US\$400 million)	a	207	223	207	223
12% Guaranteed Subordinated Bonds 2011		114	116	114	116
4 ³ / ₄ % Subordinated Notes 2011 (€850 million)		582	578	582	578
Subordinated Floating Rate Notes 2011		150	150	–	–
Subordinated Floating Rate Notes 2011		100	100	–	–
Subordinated Floating Rate Notes 2012	i	200	200	–	–
Subordinated Floating Rate Notes 2013	i	150	150	–	–
Subordinated Floating Rate Notes 2014		464	464	464	464
5 ⁷ / ₈ % Subordinated Notes 2014		148	148	148	148
6 ⁵ / ₈ % Subordinated Notes 2015		345	345	345	345
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)	a, h	353	–	353	–
5 ³ / ₄ % Subordinated Step-up Notes 2025 callable 2020	h	346	–	346	–
Subordinated Floating Rate Notes 2020 (€100 million)	a	70	70	70	70
9 ⁵ / ₈ % Subordinated Bonds 2023		338	339	338	339
Subordinated Non-Interest Bearing Loan on rolling 6 year notice		150	150	150	150
		4,774	4,874	4,174	4,269
Total subordinated liabilities		10,629	10,836	10,479	10,680

These liabilities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer.

* In certain circumstances, these notes and bonds would acquire the characteristics of preference share capital.

† Any repayments of undated loan capital would require the prior consent of the Financial Services Authority.

a) These notes bear interest at rates fixed periodically in advance based on London interbank rates.

b) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds TSB Group plc can declare or pay a dividend until any deferred payments have been made. In the event of a winding up of Lloyds TSB Bank plc, these securities will acquire the characteristics of preference shares. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on or after 25 October 2006.

c) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds TSB Group plc can declare or pay a dividend until payments are resumed. Any deferred payments will be made good on redemption of the securities. In the event of a winding up of Lloyds TSB Bank plc, these securities will acquire the characteristics of preference shares. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on or after 22 November 2007.

d) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds TSB Group plc can declare or pay a dividend until any deferred payments have been made. In the event of a winding up of Lloyds TSB Bank plc, these securities will acquire the characteristics of preference shares. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on or after 25 February 2013.

e) At the callable date, the coupon on these Notes will be reset by reference to the applicable five year benchmark gilt rate.

f) In the event that these Notes are not redeemed at the callable date, the coupon will be reset to a floating rate.

g) In the event that these Notes are not redeemed at the callable date, the coupon will be reset to a fixed margin over the then 5 year yen swap rate.

h) Issued during 2004 primarily to finance the general business of the Group.

i) The repayment date of these notes has been extended during the year.

Notes to the accounts

37 Subordinated liabilities (continued)

Dated subordinated liabilities are repayable as follows:

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
1 year or less	–	505	–	500
5 years or less but over 2 years	776	1,026	776	676
Over 5 years	3,998	3,343	3,398	3,093
	4,774	4,874	4,174	4,269

38 Non-equity minority interests

Non-equity minority interests comprise:

	2004 £m	2003 £m
Euro Step-up Non-Voting Non-Cumulative Preferred Securities (€430 million) callable 2012*	302	301
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015**	248	248
Capital instruments	550	549
European Financial Institution Investments Partnership†	–	100
LM ABS Investment Partnership††	–	34
	550	683

*These securities constitute limited partnership interests in Lloyds TSB Capital 1 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary of the Group, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.375 per cent per annum up to 7 February 2012; thereafter they will accrue at a rate of 233 basis points above EURIBOR, to be set annually.

**These securities constitute limited partnership interests in Lloyds TSB Capital 2 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary of the Group, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.834 per cent per annum up to 7 February 2015; thereafter they will accrue at a rate of 350 basis points above a rate based on the yield of specified UK government stock.

Both of these issues were made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Bank plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.

†These securities constituted interests in European Financial Institution Investments Partnership, an English law general partnership in which the principal partner was Langbourn Holdings Limited, a wholly owned subsidiary of the Group. During 2004 the partnership was dissolved and the capital returned to the partners.

††These securities constituted interests in LM ABS Investment Partnership, an English law general partnership in which the principal partner was Lime Street (Funding) Limited, a wholly owned subsidiary of the Group. During 2004 the partnership was dissolved and the capital returned to the partners.

39 Called-up share capital

	2004 £m	2003 £m
Authorised: 1,650 million ordinary shares of £1 each	1,650	1,650
: 1 cumulative floating rate preference share of £1	–	–
: 100 6% Non-Cumulative Redeemable Preference shares of £1 each	–	–
Issued and fully paid:		
: ordinary shares of £1 each		
At 1 January and 31 December	1,542	1,542
: Cumulative floating rate preference share of £1		
At 1 January and 31 December	–	–

During the year the directors approved the creation and allotment at par of 100 6% non-cumulative redeemable preference shares of £1 each. The shares, which are redeemable at the option of the Bank at any time, carry the rights to a fixed rate non-cumulative preferential dividend at a rate of 6% per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Bank.

The company regarded by the directors as the ultimate parent company is Lloyds TSB Group plc, which is also the parent undertaking of the only group of undertakings for which consolidated accounts are drawn up and of which the Bank is a member. Copies of the group accounts may be obtained from the company secretary, Lloyds TSB Group plc, 25 Gresham Street, London EC2V 7HN.

40 Reserves

	Group £m	Bank £m
Share premium account:		
At 1 January and 31 December 2004	2,960	2,960
Revaluation reserve:		
At 1 January 2004		3,374
Transfer to profit and loss account		(9)
Increase in net tangible assets of subsidiary undertakings and joint ventures		462
At 31 December 2004		3,827
Profit and loss account:		
At 1 January 2004	6,231	4,793
Exchange and other adjustments	(11)	1
Transfer from revaluation reserve	–	9
Actuarial losses recognised in post-retirement benefit schemes (note 45)	(166)	–
Goodwill written back on sale of businesses	3	–
Profit (loss) for the year	497	(42)
At 31 December 2004	6,554	4,761

The Group profit and loss account reserves at 31 December 2004 are stated after including a deficit of £2,231 million relating to the Group's post-retirement defined benefit schemes (2003: £2,139 million).

The cumulative amount of premiums on acquisitions written off against Group profit and loss account reserves during previous years amounts to £782 million of which £747 million was within the last 10 years.

Notes to the accounts

41 Shareholders' funds

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
Equity	11,056	10,733	13,090	12,669
Non-equity	-	-	-	-
	11,056	10,733	13,090	12,669

Non-equity shareholders' funds comprise 100 non-cumulative redeemable preference shares of £1 each which were issued during 2004 at par.

42 Directors' interests

The directors are also directors of Lloyds TSB Group plc and their interests in the share and loan capital of Lloyds TSB Group plc and its subsidiaries are shown in the report and accounts of that company.

43 Directors' emoluments

The aggregate of the emoluments of the directors was £8,478,000 (2003: £7,045,000).

The aggregate of the amount of the gains made by directors on the exercise of Lloyds TSB Group plc share options was £492 (2003: £295,000).

The numbers of directors to whom retirement benefits were accruing under defined contribution and defined benefit pension schemes were 2 and 6 respectively (2003: 1 and 9).

The total for the highest paid director (Mr Daniels), was £1,903,000. The amount of his accrued pension at the year end was £77,000, being his pension entitlement based on pensionable service with the Group to 31 December 2004 but payable at normal retirement age. (The total for the highest paid director in 2003 (Mr Fairey), was £1,140,000).

44 Related party transactions**a Transactions, arrangements and agreements involving directors and others**

At 31 December 2004, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons and with officers included:

	2004 Number of persons	2004 Total £000	2003 Number of persons	2003 Total £000
Loans and credit card transactions:				
Directors and connected persons	4	3,217	6	3,199
Officers	22	6,747	30	5,355

During 2003 one officer purchased a car from the Group for a consideration of £27,000.

b Group undertakings

Details of the principal group undertakings are given in note 20. In accordance with FRS 8, transactions or balances with group entities that have been eliminated on consolidation are not reported.

c Joint ventures

Details of the Group's joint ventures are provided in note 19. Information relating to transactions entered into between Group undertakings and the joint ventures and details of outstanding balances at 31 December 2004 are also shown in note 19.

44 Related party transactions (continued)**d Long-term assurance business**

The Group enters into transactions with its long-term assurance businesses, which cannot be eliminated in the consolidated accounts because of the basis of accounting used for the Group's long-term assurance businesses. After taking into account legally enforceable netting agreements, at 31 December 2004 Group entities owed £2,254 million (2003: £1,995 million) and were owed £97 million (2003: £136 million); these amounts are included in customer accounts and loans and advances to customers respectively. Furthermore Scottish Widows plc has provided £50 million (2003: £30 million) of subordinated loan capital to Scottish Widows Bank plc, which is included in other liabilities. In addition, fees of £201 million (2003: £107 million) were received, and fees of £49 million (2003: £71 million) were paid, in respect of distribution, asset management and other services.

Certain administrative properties used by Scottish Widows are owned by the long-term assurance funds. During 2004 Scottish Widows paid rent to the long-term assurance funds amounting to £5 million (2003: £5 million). In addition, at 31 December 2004, the long-term assurance funds owned 30.5 million ordinary shares in the Bank's parent company Lloyds TSB Group plc (2003: 30.5 million shares).

e Pension funds

Group entities provide a number of banking and other services to the Group's pension funds, which are conducted on similar terms to third party transactions. At 31 December 2004, the Group's pension funds had call deposits with the Bank amounting to £14 million (2003: £16 million).

45 Pensions and other post-retirement benefits**a The Group accounts**

The pension costs included in administrative expenses are comprised as follows:

	2004 £m	2003 £m
Defined contribution schemes	32	33
Defined benefit schemes	306	320
	338	353

The majority of the Group's employees are members of the defined benefit sections of Lloyds TSB Group Pension Schemes No's 1 and 2. During 2003 and 2004, no contributions have been made to the Lloyds TSB Group Pension Scheme No. 2. However, with effect from 1 July 2003 the Group recommenced contributions to the Lloyds TSB Group Pension Scheme No. 1 at a rate of 31.7 per cent of pensionable salary; this was increased to 56.5 per cent of pensionable salary with effect from 1 January 2004. Since the defined benefit sections of these schemes are now closed to new members and the age profile of the active members is increasing, under the projected unit method, the current service cost will increase as the members of the schemes approach retirement.

The latest full valuations of the above schemes were carried out as at 30 June 2002; these have been updated to 31 December 2004 by qualified independent actuaries. The last full valuations of other group schemes were carried out on a number of different dates; these have been updated to 31 December 2004 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

Notes to the accounts

45 Pensions and other post-retirement benefits (continued)

The principal assumptions used in the scheme valuations were as follows:

	31 December 2004	31 December 2003	31 December 2002
	%	%	%
Rate of inflation	2.60	2.50	2.30
Rate of salary increases	4.14	4.04	3.83
Rate of increase for pensions in payment and deferred pensions	2.60	2.50	2.30
Discount rate	5.30	5.40	5.60

In addition, the Group operates a number of schemes which provide post-retirement healthcare benefits to certain employees, retired employees and their dependent relatives. The principal scheme relates to former Lloyds Bank staff and under this scheme the Group has undertaken to meet the cost of post-retirement healthcare for all eligible former employees (and their dependants) who retired prior to 1 January 1996. For retirements subsequent to this date, the Group also met a reducing proportion of the cost until 31 December 2004, since which date the only obligation is in respect of the pre 1 January 1996 retirements.

Included within other finance income is an interest cost of £4 million (2003: £5 million) in respect of these defined benefit post-retirement healthcare schemes.

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 31 December 2000; this valuation has been updated to 31 December 2004 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 6.7 per cent.

The assets of the Group's defined benefit schemes and the expected rates of return are summarised as follows:

	Expected long-term rate of return at 31 December 2004	Expected long-term rate of return at 31 December 2003	Expected long-term rate of return at 31 December 2002	Expected long-term rate of return at 31 December 2001
Fair value at 31 December 2004	£m	£m	£m	£m
Market values of scheme assets:				
Equities	8,042	7,454	7,175	6,915
UK fixed interest gilts	550	551	557	557
UK index linked gilts	561	545	-	-
Sterling non-government bonds	941	1,033	491	566
Property	959	713	791	699
Cash	611	307	69	38
Total fair value of scheme assets	11,664	10,603	9,083	8,658

Other finance income is comprised of:

	2004 £m	2003 £m
Expected return on scheme assets	764	696
Interest cost of scheme liabilities	(725)	(662)
	39	34

45 Pensions and other post-retirement benefits (continued)

The pension and other post-retirement benefit cost in respect of defined benefit schemes is comprised of:

	2004 £m	2003 £m
Current service cost	289	269
Past service costs	17	51
Defined benefit costs	306	320

The amounts recognised in the statement of total recognised gains and losses are comprised of:

	2004 £m	2003 £m
Actual return less expected return on scheme assets	369	802
Experience gains and losses arising on scheme liabilities	(114)	94
Effect of changes in demographic and financial assumptions	(492)	(902)
Actuarial losses recognised	(237)	(6)
Deferred tax thereon	71	2
Amount recognised in the statement of total recognised gains and losses	(166)	(4)

The experience gains and losses recognised can also be analysed as follows:

	2004 £m	2003 £m	2002 £m	2001 £m
<i>Actual return less expected return on scheme assets</i>				
Amount	369	802	(2,582)	(2,015)
Percentage of scheme assets at balance sheet date	3.2%	7.6%	28.4%	18.1%
<i>Experience gains and losses arising on scheme liabilities</i>				
Amount	(114)	94	(240)	(71)
Percentage of scheme liabilities at balance sheet date	0.8%	0.7%	2.0%	0.7%
<i>Total amount recognised in the statement of total recognised gains and losses</i>				
Amount	(237)	(6)	(3,299)	(2,873)
Percentage of scheme liabilities at balance sheet date	1.6%	0.0%	27.5%	26.9%

The amounts reported on the Group's balance sheet are comprised of:

	2004 £m	2003 £m
Market value of assets	11,664	10,603
Present value of scheme liabilities	(14,851)	(13,658)
Deficit in the schemes	(3,187)	(3,055)
Related deferred tax asset	956	916
Net post-retirement benefit liability	(2,231)	(2,139)

Notes to the accounts

45 Pensions and other post-retirement benefits (continued)

The movements in the deficit in the schemes over the year have been as follows:

	2004 £m	2003 £m
Deficit at beginning of year	(3,055)	(2,931)
Exchange and other adjustments	(2)	(4)
Other finance income	39	34
Current service costs	(289)	(269)
Contributions	374	138
Past service costs	(17)	(51)
Actuarial loss	(237)	(6)
Adjustments on disposal	-	34
Deficit at end of year	<u>(3,187)</u>	<u>(3,055)</u>

b The Bank accounts

The majority of the Bank's employees are members of the Group's two main pension schemes, Lloyds TSB Group Pension Schemes No's 1 and 2, along with employees of a number of the Bank's subsidiaries. Because it is not possible to separately identify the amount of any surpluses or deficits in these schemes relating to each employing company, in the accounts of the Bank, these schemes are accounted for as defined contribution schemes.

46 Contingent liabilities and commitments

	Group		Bank	
	2004 £m	2003 £m	2004 £m	2003 £m
<i>Contingent liabilities:</i>				
Acceptances and endorsements	71	299	37	269
Guarantees	6,786	6,122	6,899	6,150
Other:				
Other items serving as direct credit substitutes	345	1,069	347	1,095
Performance bonds and other transaction-related contingencies	1,324	1,534	1,339	1,552
Other contingent liabilities	-	1	-	1
	<u>1,669</u>	<u>2,604</u>	<u>1,686</u>	<u>2,648</u>
	<u>8,526</u>	<u>9,025</u>	<u>8,622</u>	<u>9,067</u>
<i>Commitments:</i>				
Documentary credits and other short-term trade-related transactions	431	368	406	422
Forward asset purchases and forward deposits placed	1,654	546	1,654	546
Undrawn formal standby facilities, credit lines and other commitments to lend:				
- Less than 1 year maturity	63,196	62,440	60,922	60,771
- 1 year or over maturity	20,009	15,981	18,810	14,896
	<u>85,290</u>	<u>79,335</u>	<u>81,792</u>	<u>76,635</u>
<i>Incurred on behalf of group undertakings:</i>				
Contingent liabilities			186	127
Commitments			4	72
			<u>190</u>	<u>199</u>

47 Derivatives and other financial instruments

The Group's activities can be divided into three broad categories: banking and mortgages, insurance and investments, and trading activities.

Banking and mortgage activities represent the most significant element of the Group's business in terms of profit, assets and exposure to risk. These activities are entered into in both the UK and overseas and principally comprise the Group's core business of lending and deposit taking, involving a full range of personal and corporate customers. In entering into this business, the Group's objective is to secure a margin between the interest paid to customers on their deposits and interest received on amounts advanced. In order to do this, more complex financial instruments, such as derivatives, are used as a means of reducing risk by hedging exposures to movements in exchange rates, interest rates or other market variables.

Within its banking activities, the Group has a number of treasury operations that are responsible for utilising surplus funds and meeting funding shortfalls by entering into transactions in the money markets. Portfolios of debt securities and treasury bills are held to provide a source of liquidity. It is the Group's intention to hold these investments until maturity although in certain circumstances they may be disposed of before then where, for example, the need to hold the investment no longer applies. Any profits or losses arising from a sale of this kind are recognised immediately.

Insurance and investment businesses provide general insurance and market savings and investment products both within and outside the banking customer bases. Fund management services are also provided although, whilst involving external clients, this activity is currently dominated by the management of internal group funds.

Trading activities are restricted to a few highly specialist authorised trading centres, the principal one being the Group's Treasury department in London. Most of the Group's trading activity is to meet the requirements of customers for foreign exchange and interest rate products, from which the Group is able to earn a spread on the rates charged. However, interest rate and exchange rate positions are taken out using derivatives (forward foreign exchange contracts, interest rate swaps and forward rate agreements) and on-balance sheet instruments (mainly debt securities). The objective of these positions is to earn a profit from favourable movements in market rates. Accordingly, these transactions are reflected in the accounts at their fair value and gains and losses shown in the profit and loss account as dealing profits.

Risk

The board is responsible for determining the long-term strategy of the business, the markets in which the Group will operate and the level of risk acceptable to the Group in each area of its business. The principal risks arising from the Group's use of financial instruments are as follows:

Credit risk

Credit risk arises from extending credit in all forms in the Group's banking and trading activities, where there is a possibility that a counterparty may default. The Group has dedicated standards, policies and procedures to control and monitor all such risks. Lloyds TSB Group Risk's responsibilities in respect of credit risk include the following:

- Formulation of high level credit policies designed to ensure a balanced and managed approach to the identification and mitigation of credit risk. These policies provide a standard framework within which Group businesses structure their individual policies and rules. Lloyds TSB Group Risk reviews, approves and monitors credit policy documents established for individual businesses.
- Provision of lending guidelines. These define the responsibilities for lending officers and provide a disciplined and focused benchmark for sound credit decisions. Clear guidance is provided on the Group's attitude towards and appetite for credit exposure on different market sectors, industries and products.

Notes to the accounts

47 Derivatives and other financial instruments (continued)

- Counterparty limits. Exposure to individual counterparties, groups of counterparties or customer segments is controlled through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk. Regular reports on significant credit exposures are provided to the group executive committee and board.
- Provision of a group rating system. All business units are required to operate an authorised rating system that complies with the Group's standard methodology. The Group uses a 'Master Scale' rating structure with ratings corresponding to a range of probabilities of future default.
- Establishment and maintenance of the Group's large exposure policy. Exposure to individual counterparties, groups of counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk.
- Control of bank exposures. In-house proprietary rating systems are used to approve bank facilities on a group basis.
- Monitoring of scorecards. The Group utilises statistically-based decisioning techniques (primarily credit scoring and performance scoring) for its principal consumer lending portfolios. Lloyds TSB Group Risk reviews and monitors new and material changes to scorecards.
- Control of cross-border exposures. Country limits are authorised and managed by a dedicated unit, using an in-house rating system which takes into account economic and political factors.
- Maintenance of a centralised facilities database. Lloyds TSB Group Risk operates a centralised database of large corporate, sovereign and bank facilities designed to ensure that a consistent aggregation policy is maintained throughout the Group.
- Formulation of concentration limits on certain industries and sectors and monitoring and controlling residual value risk exposure. Lloyds TSB Group Risk sets sector caps that reflect risk appetite and monitors exposures to prevent excessive concentration of risk.
- Portfolio analysis. In conjunction with Lloyds TSB Group Risk, group businesses identify and define portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposure. This entails the production and analysis of regular portfolio monitoring reports for review by Lloyds TSB Group Risk.
- Communication and provision of general guidance on all credit-related risk issues, including regulatory changes and environmental risk policy, to promote consistent and best practice throughout the Group.

Day-to-day credit management and asset quality within each business unit is the primary responsibility of the business unit directors. Each business unit has in place established credit processes which are consistent with corresponding Group policies. Authority to delegate lending authorities within business units rests with officers holding divisional delegated lending authority. All material authorities are advised to Lloyds TSB Group Risk.

Specialist units are established within group business units to provide, for example: intensive management and control; security perfection, maintenance and retention; expertise in documentation for lending and associated products; sector-specific expertise; and legal services applicable to the particular market place and product range offered by the business unit.

Credit risk exposures in the insurance businesses arise primarily from holding investments and from exposure to reinsurers. Control is exercised over those exposures through a suitable combination of formal limits, credit policy parameters and high level committee oversight.

47 Derivatives and other financial instruments (continued)**Market risk**

Market risk is the risk of losses being incurred as a result of adverse movements in interest or exchange rates or other market variables. Market risk arises in all areas of the Group's activities and is managed by a variety of different techniques.

Trading activities are restricted to a few highly specialist trading centres and the level of exposure is strictly controlled and monitored within approved limits locally and centrally.

A variety of techniques are used to quantify the market risk arising from the Group's banking and trading activities. These reflect the nature of the business activity, and include simple interest rate gapping, open exchange positions, sensitivity analysis and Value at Risk (VaR). Stress testing and scenario analysis are also used in certain portfolios, and at Group level, to simulate extreme conditions to supplement these core measures.

Various parameters are used to calculate the value at risk on a given portfolio of positions, thus avoiding undue reliance on a single measure. Based on the commonly quoted 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding three years, during 2004 the value at risk on the Group's global trading averaged £1.3 million (2003: £1.5 million) with a maximum of £2.0 million (2003: £2.6 million) and a minimum of £0.8 million (2003: £0.9 million). The figure at 31 December 2004 was £0.9 million (2003: £1.0 million).

Lloyds TSB Group Balance Sheet Management (GBSM) specifically focuses on the management of interest rate risk in the Group's retail portfolios, including mortgages, and in the Group's capital funds. GBSM reports to an Asset and Liability Committee. The Group's policy is to optimise the stability of future net interest income, which is achieved by entering into hedging transactions using interest rate swaps and other financial instruments.

Within the insurance businesses the with-profits funds are managed in accordance with the relevant fund's Principles and Practices of Financial Management. This leads to assets and liabilities that are mismatched with the aim of generating a higher rate of return to meet policyholders' expectations. Unit-linked liabilities are matched with the same assets that are used to define the liability but future fee income is dependent upon the performance of these assets.

Liquidity risk

A Group Liquidity Policy is in place which requires a common methodology for measuring liquidity across the Group. The methodology derives a liquidity ratio calculated by taking the sum of liquid assets, five-day wholesale inflows and back-up lines, and then dividing this by the sum of five-day wholesale outflows and a percentage of retail maturities and contingent claims drawable over the next five days.

The Liquidity Policy requires all authorised local treasury operations to maintain a liquidity ratio of over 100 per cent, in addition to ensuring compliance with local regulatory requirements.

It is the responsibility of local line management to ensure that the Liquidity Policy is met, and the sources and maturities of assets and liabilities are continually managed and appropriately diversified to avoid any undue concentration as market conditions evolve. Compliance is monitored by regular liquidity returns to Lloyds TSB Group Risk Management.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. For internal purposes, reputational impact is also included.

Business units have primary responsibility for identifying and managing their operational risks. They employ internal control techniques to reduce their likelihood or impact to tolerable levels within the Group's risk appetite. Where appropriate, risk is mitigated by way of insurance.

Notes to the accounts

47 Derivatives and other financial instruments (continued)

Lloyds TSB Group Risk's responsibilities in relation to operational risk include defining high-level operational risk policies to ensure a comprehensive and consistent approach to the identification and management of operational risk; implementation of a Group-wide standard methodology to ensure consistency in the identification, assessment and management of operational risk; communication and provision of general guidance on operational risk related issues, including regulatory changes and developments in the measurement and management of operational risk, to promote best practice throughout the Group; continuous review and improvement of all aspects of operational risk management to reflect developments in industry best practice and regulatory requirements; approval from a risk perspective of all new products launched throughout the Group, to ensure that risks inherent in new products have been identified and mitigated.

Insurance risk

The Group offers insurance products to its customers, and actively reviews the extent to which the associated risk is underwritten internally, or reinsured with external underwriters.

The Financial Services Authority sets down minimum requirements for solvency and reserving for all classes of insurance, which are carefully monitored by the relevant business units within the Group. The retained risk level is carefully controlled and monitored, with close attention being paid to the analysis of underwriting experience, product design, policy wordings, adequacy of reserves, solvency management and regulatory requirements.

General insurance exposure to accumulations of risk and possible catastrophes is mitigated by reinsurance arrangements which are broadly spread over different reinsurers. Appropriate reinsurance arrangements also apply within the life and pensions businesses. Options and guarantees are incorporated in new insurance products only after careful consideration of the risk management issues that they present. This occurs as part of the new product approval process. Expenses are monitored by an analysis of experience relative to budget. Reasons for any significant divergence from expectation are investigated and remedial action taken. Persistency rates are regularly assessed by reference to appropriate risk factors.

Derivatives

Derivatives are used to meet the financial needs of customers, as part of the Group's trading activities and to reduce its own exposure to fluctuations in interest and exchange rates. The principal derivatives used by the Group are interest rate and exchange rate contracts; particular attention is paid to the liquidity of the markets and products in which the Group trades to ensure that there are no undue concentrations of activity and risk.

Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date.

Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. A currency option gives the buyer, on payment of a premium, the right, but not the obligation, to sell a specified amount of currency at an agreed rate of exchange on or before a specified future date.

47 Derivatives and other financial instruments (continued)

Equity derivatives are also used by the Group as part of its equity based retail product activity to eliminate the Group's exposure to fluctuations in various international stock exchange indices. Index-linked equity options are purchased which give the Group the right, but not the obligation, to buy or sell a specified amount of equities, or basket of equities in the form of published indices on or before a specified future date.

Derivatives contracts expose the Group to both market risk and credit risk. Only a few highly specialist trading centres within the Group are permitted to enter into derivative contracts and the level of exposure to interest rate and exchange rate movements and other market variables is strictly controlled and monitored within approved limits.

Unlike on-balance sheet instruments the principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group, should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure.

a Derivatives Group**Trading**

The notional principal amounts and fair values (which, after netting, are the carrying values) of trading instruments entered into with third parties were as follows:

	Notional principal amount £m	Fair values	
		Assets £m	Liabilities £m
31 December 2004			
<i>Exchange rate contracts:</i>			
Spot, forwards and futures	113,601	1,995	2,632
Currency swaps	11,850	426	628
Options purchased	2,059	44	-
Options written	1,922	-	41
	129,432	2,465	3,301
<i>Interest rate contracts:</i>			
Interest rate swaps	276,476	3,118	3,792
Forward rate agreements	62,797	28	24
Options purchased	9,679	78	-
Options written	7,430	-	163
Futures	48,278	-	-
	404,660	3,224	3,979
Equity and other contracts	4,239	282	19
Effect of netting		(3,956)	(3,956)
Balances arising from off-balance sheet financial instruments		2,015	3,343

Notes to the accounts

47 Derivatives and other financial instruments (continued)

	Notional principal amount £m	Fair values	
		Assets £m	Liabilities £m
31 December 2003			
<i>Exchange rate contracts:</i>			
Spot, forwards and futures	76,368	1,669	2,127
Currency swaps	10,793	328	557
Options purchased	1,678	55	14
Options written	1,542	–	39
	<u>90,381</u>	<u>2,052</u>	<u>2,737</u>
<i>Interest rate contracts:</i>			
Interest rate swaps	238,384	3,346	4,180
Forward rate agreements	54,213	29	29
Options purchased	10,475	145	–
Options written	5,265	–	162
Futures	38,626	–	–
	<u>346,963</u>	<u>3,520</u>	<u>4,371</u>
Equity and other contracts	<u>5,407</u>	<u>693</u>	<u>387</u>
Effect of netting		<u>(3,776)</u>	<u>(3,776)</u>
Balances arising from off-balance sheet financial instruments		<u>2,489</u>	<u>3,719</u>

Non-trading

Through intra company and intra group transactions, Group companies establish non-trading derivatives positions with the Group's independent trading operations, which then enter into similar positions with third parties. The notional principal amounts and fair values of non-trading instruments entered into with third parties were as follows:

	Notional principal amount £m	Fair values	
		Positive £m	Negative £m
31 December 2004			
<i>Exchange rate contracts:</i>			
Spot, forwards and futures	155	3	3
Currency swaps	60	2	–
Options purchased	1	–	–
	<u>216</u>	<u>5</u>	<u>3</u>
<i>Interest rate contracts:</i>			
Interest rate swaps	34,196	143	350
Forward rate agreements	2,921	6	–
Options written	111	–	–
	<u>37,228</u>	<u>149</u>	<u>350</u>
Effect of netting		<u>(123)</u>	<u>(123)</u>
		<u>31</u>	<u>230</u>

47 Derivatives and other financial instruments (continued)

	Notional principal amount £m	Fair values	
		Positive £m	Negative £m
31 December 2003			
<i>Exchange rate contracts:</i>			
Spot, forwards and futures	171	13	5
Currency swaps	459	28	10
	<u>630</u>	<u>41</u>	<u>15</u>
<i>Interest rate contracts:</i>			
Interest rate swaps	30,816	256	260
Forward rate agreements	7,188	1	1
Options written	40	–	–
	<u>38,044</u>	<u>257</u>	<u>261</u>
Effect of netting		<u>(165)</u>	<u>(165)</u>
		<u>133</u>	<u>111</u>

The aggregate carrying value of non-trading derivatives with a positive fair value was an asset of £96 million (2003: an asset of £132 million) and with a negative fair value was a liability of £35 million (2003: a liability of £71 million).

The maturity of the notional principal amounts and replacement cost of both trading and non-trading instruments entered into with third parties was:

	Under 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
31 December 2004				
<i>Exchange rate contracts:</i>				
Notional principal amount	117,027	8,143	4,478	129,648
Replacement cost	2,015	179	276	2,470
<i>Interest rate contracts:</i>				
Notional principal amount	224,427	165,524	51,937	441,888
Replacement cost	521	1,426	1,426	3,373
<i>Equity and other contracts:</i>				
Notional principal amount	583	3,358	298	4,239
Replacement cost	6	258	18	282
<i>Total:</i>				
Notional principal amount	342,037	177,025	56,713	575,775
Replacement cost	2,542	1,863	1,720	6,125
31 December 2003				
<i>Exchange rate contracts:</i>				
Notional principal amount	79,677	7,005	4,329	91,011
Replacement cost	1,753	141	199	2,093
<i>Interest rate contracts:</i>				
Notional principal amount	175,306	161,834	47,867	385,007
Replacement cost	578	1,660	1,539	3,777
<i>Equity and other contracts:</i>				
Notional principal amount	2,886	1,965	556	5,407
Replacement cost	523	115	55	693
<i>Total:</i>				
Notional principal amount	257,869	170,804	52,752	481,425
Replacement cost	2,854	1,916	1,793	6,563

Notes to the accounts

47 Derivatives and other financial instruments (continued)

The maturity of the notional principal amounts and replacement cost of both trading and non-trading instruments entered into with third parties was:

	Under 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
31 December 2004				
<i>Exchange rate contracts:</i>				
Notional principal amount	119,283	8,994	4,478	132,755
Replacement cost	2,059	354	276	2,689
<i>Interest rate contracts:</i>				
Notional principal amount	226,396	169,648	54,955	450,999
Replacement cost	528	1,500	1,556	3,584
<i>Equity contracts:</i>				
Notional principal amount	946	5,556	596	7,098
Replacement cost	6	258	18	282
<i>Total:</i>				
Notional principal amount	346,625	184,198	60,029	590,852
Replacement cost	2,593	2,112	1,850	6,555
31 December 2003				
<i>Exchange rate contracts:</i>				
Notional principal amount	80,994	7,864	4,329	93,187
Replacement cost	1,823	265	199	2,287
<i>Interest rate contracts:</i>				
Notional principal amount	176,688	166,655	51,019	394,362
Replacement cost	587	1,775	1,685	4,047
<i>Equity and other contracts:</i>				
Notional principal amount	3,317	3,539	1,111	7,967
Replacement cost	523	115	55	693
<i>Total:</i>				
Notional principal amount	260,999	178,058	56,459	495,516
Replacement cost	2,933	2,155	1,939	7,027

An analysis of the net replacement cost of both trading and non-trading instruments entered into with third parties by counterparty type is set out below; the Bank's exposure is further reduced by qualifying collateral held.

	2004 £m	2003 £m
OECD banks	1,288	1,741
Other	1,188	1,345
Net replacement cost	2,476	3,086
Qualifying collateral held	(592)	(416)
Potential credit risk exposure	1,884	2,670

Notes to the accounts

47 Derivatives and other financial instruments (continued)**b Interest rate sensitivity gap analysis for the non-trading book**

The table below summarises the repricing mismatches of the Group's non-trading assets and liabilities. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date.

	3 months or less £m	6 months or less but over 3 months £m	1 year or less but over 6 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non- interest bearing £m	Trading book £m	Total £m
As at 31 December 2004								
<i>Assets:</i>								
Treasury bills and other eligible bills	43	40	–	5	–	–	4	92
Loans and advances to banks	19,663	1,351	154	470	82	602	1,243	23,565
Loans and advances to customers	99,356	6,443	6,937	36,783	6,203	(54)	313	155,981
Debt securities and equity shares	8,193	1,009	770	1,976	2,527	(68)	11,002	25,409
Other assets	121	–	–	5	1	17,382	4,271	21,780
Total assets	127,376	8,843	7,861	39,239	8,813	17,862	16,833	226,827
<i>Liabilities:</i>								
Deposits by banks	36,802	2,009	289	122	81	212	223	39,738
Customer accounts	109,789	1,083	823	5,639	538	3,891	591	122,354
Debt securities in issue	18,764	1,848	1,171	1,435	3,999	–	–	27,217
Other liabilities	292	–	–	–	–	9,008	5,937	15,237
Subordinated liabilities – loan capital	2,299	459	–	1,652	6,069	150	–	10,629
Minority interests and shareholders' funds	–	–	–	–	–	11,629	23	11,652
Internal funding of trading business	(6,577)	635	129	(3,330)	(916)	–	10,059	–
Total liabilities	161,369	6,034	2,412	5,518	9,771	24,890	16,833	226,827
Off-balance sheet items	13,254	(3,902)	(2,424)	(9,468)	2,540	–	–	–
Interest rate repricing gap	(20,739)	(1,093)	3,025	24,253	1,582	(7,028)	–	–
Cumulative interest rate repricing gap	(20,739)	(21,832)	(18,807)	5,446	7,028	–	–	–
As at 31 December 2003								
<i>Assets:</i>								
Treasury bills and other eligible bills	408	48	65	6	3	–	9	539
Loans and advances to banks	10,686	1,311	463	746	86	366	1,889	15,547
Loans and advances to customers	88,466	4,681	5,549	30,777	6,171	(51)	1,424	137,017
Debt securities and equity shares	8,718	606	279	1,856	2,372	(55)	15,351	29,127
Other assets	101	–	17	8	–	16,055	5,287	21,468
Total assets	108,379	6,646	6,373	33,393	8,632	16,315	23,960	203,698
<i>Liabilities:</i>								
Deposits by banks	22,254	635	262	286	99	205	214	23,955
Customer accounts	104,621	705	876	5,227	1,173	3,749	593	116,944
Debt securities in issue	18,375	1,507	1,040	1,210	3,790	–	–	25,922
Other liabilities	300	–	–	–	–	7,933	6,348	14,581
Subordinated liabilities – loan capital	2,689	1,089	–	677	6,231	150	–	10,836
Minority interests and shareholders' funds	–	–	–	–	–	11,442	18	11,460
Internal funding of trading business	(11,528)	(810)	(412)	(3,217)	(820)	–	16,787	–
Total liabilities	136,711	3,126	1,766	4,183	10,473	23,479	23,960	203,698
Off-balance sheet items	6,930	(1,365)	(4,049)	(2,596)	1,080	–	–	–
Interest rate repricing gap	(21,402)	2,155	558	26,614	(761)	(7,164)	–	–
Cumulative interest rate repricing gap	(21,402)	(19,247)	(18,689)	7,925	7,164	–	–	–

The table above does not take into account the effect of interest rate options used by the Group to hedge its exposure; details of options are given in note 47a.

Notes to the accounts

47 Derivatives and other financial instruments (continued)**c Fair value analysis**

The table below shows a comparison by category of book values and fair values of the Group's on-balance sheet financial assets and liabilities:

As at 31 December 2004

	Trading book		Non-trading book	
	Book value £m	Fair value £m	Book value £m	Fair value £m
<i>Assets:</i>				
Treasury bills and other eligible bills	4	4	88	90
Loans and advances to banks and customers	1,556	1,556	177,990	178,453
Debt securities and equity shares	11,002	11,002	14,407	14,443
<i>Liabilities:</i>				
Deposits by banks and customers	814	814	161,278	161,242
Debt securities in issue	-	-	27,217	26,924
Subordinated liabilities	-	-	10,629	11,920

As at 31 December 2003

	Trading book		Non-trading book	
	Book value £m	Fair value £m	Book value £m	Fair value £m
<i>Assets:</i>				
Treasury bills and other eligible bills	9	9	530	523
Loans and advances to banks and customers	3,313	3,313	149,251	150,636
Debt securities and equity shares	15,351	15,351	13,776	13,885
<i>Liabilities:</i>				
Deposits by banks and customers	807	807	140,092	140,143
Debt securities in issue	-	-	25,922	26,254
Subordinated liabilities	-	-	10,836	11,916

The disclosures in this note cover all on-balance sheet financial instruments; fair values of all derivative instruments are disclosed in note 47a.

Fair values are determined by reference to quoted market prices or, where no market price is available, using internal models which discount expected future cashflows at prevailing interest rates.

Fair values have not been calculated for sundry debtors and creditors in the trading book.

47 Derivatives and other financial instruments (continued)**d Currency exposures***Structural currency exposures*

Structural currency exposures arise from the Group's investments in its overseas operations. The structural position is managed after having regard to the currency composition of the Group's risk-weighted assets, the objective being to limit the effect of exchange rate movements on the published risk asset ratio.

The Group's main overseas operations are in the Americas and Europe. Details of the Group's structural foreign currency exposures are as follows:

	2004 £m	2003 £m
Functional currency of Group operation:		
Euro	289	287
US dollar	271	255
Swiss franc	58	104
Other non-sterling	202	200
Total	820	846

Non-structural currency exposures

All foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled.

e Unrecognised gains and losses on hedging instruments

The Group uses a variety of financial instruments to hedge exposures in its banking book; these hedges are accounted for on an accruals basis, in line with the underlying instruments being hedged. Any gains or losses that would occur if these instruments were carried at market value are therefore not recognised.

At 31 December 2004, the unrecognised gains on financial instruments used for hedging were £272 million (2003: £303 million) and unrecognised losses were £424 million (2003: £219 million).

The net gains arising in 2003 and earlier years and recognised in 2004 amounted to £3 million. Net losses of £228 million arose in 2004 but were not recognised in the year.

Of the net losses of £152 million at 31 December 2004, £49 million of net losses are expected to be recognised in the year ending 31 December 2005 and £103 million of net losses in later years.

